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High Pointe

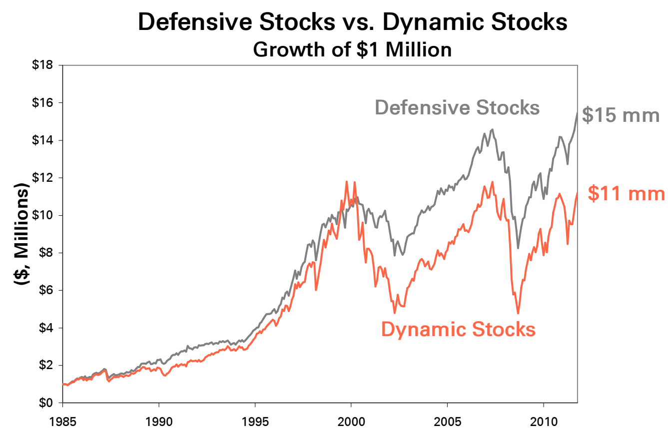
DATE: April 17, 2012
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

Tastes Great, Less Filling

A good offense is the best defense. This phrase is used in sports to convey the thought that it is better to attack than be attacked. Sports enthusiasts would be well advised to leave their couch potato wisdom at the doorstep as they enter the stock market arena because in the stock market it is more rewarding to play defense than offense. Here is the proof.

About a year ago, Russell Investments, the creator of popular market benchmarks such as the Russell 2000 Index, created two new indexes. They are called the Russell Defensive Index and the Russell Dynamic Index. Broadly speaking, the Defensive Index is made up of less risky companies and Dynamic Index is made up of more risky companies.

Russell calculated historical returns for these two indexes going back 25 years and found that an investor putting his money in the Defensive index would have decisively beaten another investor putting his money in the Dynamic Index, as shown in the chart to the right. Not only that, the risk of Defensive stocks was almost one-third lower than that of Dynamic stocks.[1] In other words, not only did Defensive stocks "Taste Great" but they were "Less Filling" as well.



Source: Russell Investments data from Russell 1000 Stability Indexes

[The tag line "Tastes Great, Less Filling" is from a Miller Lite campaign that was rated one of the Top 10 campaigns of the 20th century by <u>Advertising Age</u>. Conventional wisdom during the early days of low calorie beer was that less filling (low calorie) beer did not taste good. Miller advertised that its beer had both of the two qualities that were supposed to be mutually exclusive -- great taste and low calories. In the same vein, Defensive stocks have shown two characteristics that are generally assumed to be mutually exclusive, i.e., higher return and lower risk.]

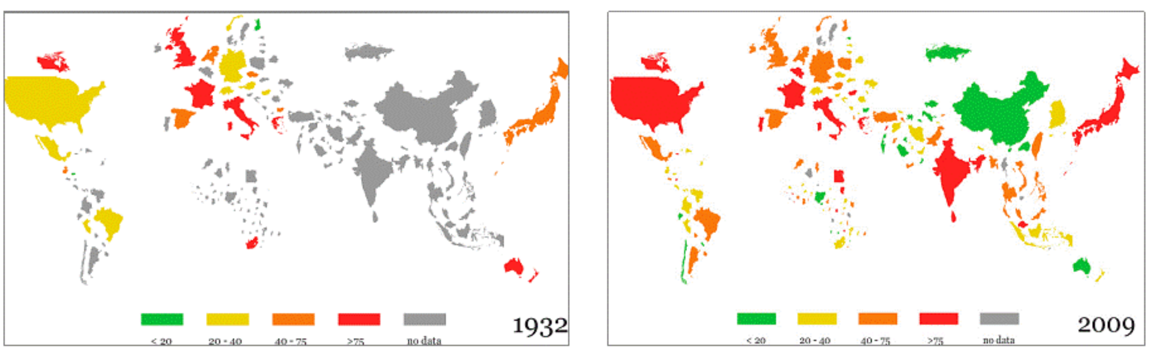
[1] *Volatility (measured by standard deviation) was 13.3% for Defensive stocks and 19.7% for Dynamic stocks.*

The superiority of Defensive stocks over the past 25 years run does not mean that they were the best choice over every sub-period. In fact, 46% of the time Defensive stocks underperformed on a rolling three-year basis. Moreover, the magnitude of underperformance at times was enormous. For example, for three years ending March 31, 2000, Defensive stocks produced a return of 81% compared to 141% for Dynamic stocks.

Last year, we developed a proprietary technique to measure the defensive score of every stock. Now we know more precisely how we are positioned compared to the market in terms of defensiveness. We are also able to quickly and efficiently change the risk profile of our portfolio depending upon our assessment of the investment opportunities in front of us and our view of the economic environment.

Our current assessment is that we like the investment opportunities at the company level but we do not like the economic environment. At the company level, we can identify a number of companies that have safe balance sheets, entrenched franchises, secular growth and reasonable valuations. At the broad economic level, we see numerous risks. We do not need to reproduce the list of such risks here because everyone has seen it many times. All you have to do is to pick up the newspaper (I mean, turn on your iPad) and it is all there in black and white (I mean, in color). We do, however, want to share a unique graph contrasting today's economic environment with another important time period from a bygone era. This graph, courtesy of IMF, uses a "heat index" type of data to show how our world is running a lot hotter (riskier) compared to the last time we had a serious financial crisis.

Debt Levels around the World
Great Depression (1932) vs. Great Recession (2009)



Source: "A Historical Public Debt Database" IMF Working Paper 10/245, Country size is scaled according to 2009 GDP.
Red: Debt/GDP > 75%, Orange: 40% - 75%, Yellow: 20% - 40%, Green: Less than 20%, Grey: No Data

All things considered, our scouting report and our game plan for the near future is as follows.

- The field is slippery.
  - *Translation:* Macro economic environment is riskier than normal.
- We need cleats with better traction.
  - We need to invest more heavily in Defensive stocks.
- We have excellent defensive players.
  - There are many strong, growing companies selling at reasonable valuations
- We will "go long" at times when the opportunity is right.
  - We will invest in Dynamic stocks when valuations become compelling.

Investment Returns

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

Investment Performance (Net of Fees)[1]

For Periods Ending March 31, 2012

	One Quarter	One Year	Three Years	Ten Years	Since Inception[2]
Small Cap	14.6%	5.0%	28.6%	8.0%	9.2%
Russell 2000 Index	12.4%	-0.2%	27.0%	6.5%	6.0%
Value Added	**+2.2%**	**+5.2%**	**+1.6%**	**+1.5%**	**+3.2%**
Large Cap Value	11.9%	2.7%	19.7%	3.3%	8.6%
Russell 1000 Value Index	11.1%	4.8%	22.9%	4.6%	5.2%
Value Added	**+0.8%**	**-2.1%**	**-3.2%**	**-1.3%**	**+3.4%**
Large Cap Growth	15.1%	15.0%	23.4%	4.3%	7.6%
Russell 1000 Growth Index	14.7%	11.0%	25.3%	4.3%	1.0%
Value Added	**+0.4%**	**+4.0%**	**-1.9%**	**+0.0%**	**+6.6%**
International Equity	13.8%	-3.2%	20.5%	N/A	0.3%
MSCI AC World ex US Index[3]	11.2%	-7.2%	19.3%	N/A	-0.5%
Value Added	**+2.6%**	**+4.0%**	**+1.2%**	**N/A**	**+0.8%**

[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 14.6% during the quarter, outperforming the Russell 2000 Index by 2.2%. During the quarter, security selection in the health care and financial sectors added value.

In the health care sector, our portfolios benefited from an increase in clinical research trials and higher productivity. In addition, our investment in the biotechnology industry was acquired at a substantial premium. Our commercial real estate industry investment also performed well as it continued to gain market share.

During the quarter we took profits in health care companies across various industries (pharmaceuticals, genetic analysis) that had reached our price targets and reinvested the profits in biotechnology and medical equipment industries. We also sold our auto parts and auto auction industry investments in favor of industrial auctions, semiconductors and systems software.

Large Cap Value

High Pointe's Large Cap Value strategy produced a return of 11.9%, which exceeded its benchmark, the Russell 1000 Value Index by 0.8%. During the quarter, security selection in the technology and financial sectors added value.

In the technology sector, our investments in the software industry outperformed as competitive concerns eased and growth forecasts improved. In addition, our banking industry investments benefited from passing the Federal Reserve's stress test. However, our investment in the oil and gas service industry struggled due to growth concerns and subpar execution.

During the quarter we increased our investments in the technology and financial sectors with proceeds from the industrial and consumer discretionary sectors. We sold investments in the construction equipment, home improvement retail, and household product industries and invested the proceeds in the software, computer and insurance industries.

Large Cap Growth

High Pointe's Large Cap Growth strategy produced a return of 15.1%, outperforming its benchmark, the Russell 1000 Growth Index by 0.4% for the quarter. Our portfolio benefited from strong stock selection in the health care sector and sector selection from an overweighting of the technology sector.

In the health care sector, our biotechnology industry investment was acquired at a substantial premium. In addition, our investments in consumer electronics and communications equipment industries outperformed because of strong uptake of "smart" phones. However, our computer industry investment struggled because of a decline in market share. We are maintaining this investment because we believe the restructuring that is underway will unlock the inherent value.

During the quarter we increased our investments in technology and reduced our allocation to the materials and consumer discretionary sectors. We reallocated our health care investments out of orthopedic medical instruments and into cardio and dental. In addition, we repositioned our energy investments into higher growth exploration and fuel logistics investments.

International Equity
High Pointe's International Equity strategy produced a return of 13.8%, exceeding the MSCI All Country World ex-US Index by 2.6% for the quarter.

Over the quarter, our automobile industry holdings performed well as growth exceeded expectations in part because of strong demand for luxury cars in China. In addition, our investment in the commercial air conditioning industry outperformed as execution improved. Our European banking industry holdings benefited as the Euro zone crisis abated a bit.

During the quarter we increased our holdings in the technology and consumer discretionary sectors and reduced our investments in the consumer staples and financial sectors. We repositioned our financial sector holdings by reducing our bank industry holdings and increasing our investments in the insurance and real estate industries. In addition, we sold holdings in liquor and communications equipment industries and invested the proceeds in semiconductors and construction equipment industries.

* * *

We are pleased to be off to a good start in 2012 in terms of both absolute and relative performance and look forward to reporting our results again in July 2012. Thank you for the opportunity to manage your assets!