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High Pointe

DATE: July 24, 2012
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

The Sum of All Fears

Why, you can take the most gallant sailor, the most intrepid airman or the most audacious soldier, put them at a table together - what do you get? The sum of their fears.
– *Winston Churchill*

Ask people about the stock market these days and their perception typically is a combination of fear and disdain. Such negative perception keeps them from noticing that for the fourth straight year the market is up nicely and that the average return on the S&P 500 since the beginning of 2009 has been 15% per year.

One reason for this phenomenon is that the headlines around us are negative. Here is a sampling.

Investors' negative perception is also framed by their experience since the bursting of the internet bubble twelve years ago. During this period the market has experienced several declines of over 15% leaving investors disillusioned. Such disillusion and fear can make investors blind to future investment opportunities. Below, we highlight some key risks investors see today and discuss whether these risks should sway their decision making.

Fear	Relevance for Investing
Global economy is slowing down.	• Economic slowdown is real, but stock market is forward looking and it has little correlation with short-term economic growth. • Since a slowdown is widely expected it is already reflected in current stock prices. Only if the slowdown turns out to be worse than expected will the stock market decline further.
Corporate profits are at peak margin. They can only go down.	• It is true that corporate profits are higher than they have ever been and some reversal is likely. • However, employees have little bargaining power and therefore corporate profitability might stay at a higher level than the historical normal level. • Moreover, corporate balance sheets are very strong and they offer an extra element of security that they did not have before. Remember, ExxonMobil is AAA rated, the U.S. government is not.
Investor sentiment is bearish.	• That is good news for smart investors. Investor sentiment is usually a contrarian signal. Our research shows that if over the last 25 years if an investor had bought stocks when others were highly bearish[1], he would have seen a price appreciation of 9%, but if he had bought when others were highly bullish he would have lost 1% over the next year.
European stocks and emerging market stocks pose significant risks.	• Indeed they do. But they also present opportunities. Many European companies generate most of their revenue from outside Europe and will benefit from a decline in the Euro. • European stocks sell at a price-to-forward earnings ratio of only 9.7 compared to their 20 year average of 15.7. The current level is not far from the level of 8.5 at the beginning of March 2009, just before the market roared higher.[2] • Emerging markets' growth rates are higher than that of the developed world, they are creditors to us, and their demographics in many cases are more favorable.

Franklin D. Roosevelt once said "The only thing we have to fear, is fear itself". Fear is a factor keeping a lid on stock prices. It is also making some investors paralyzed; unable to take action. Our view is that for smart investors a healthy dose of fear is justified but inaction is not. High Pointe is taking action now to evaluate investment opportunities caused by the sum of all fears. Right now that means we are balancing the goals of high quality (stability) and economic sensitivity (cyclicality) in our portfolios. If stock prices decline further we expect to find additional buying opportunities in quality cyclical stocks.

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[1] Based on AAII Investor Sentiment Survey (www.aaii.com) weekly Bull-Bear Spread from June 26, 1987 – July 19, 2012. Highly Bullish is defined as outside of {Average Spread plus two standard deviations}. Highly Bearish is defined as outside of {Average Spread minus two standard deviations}. Return calculated based on subsequent S&P 500 52-week price change.

[2] Source: Thomson Reuters based on MSCI Europe Index.

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 June 30, 2012

	One Quarter	One Year	Five Years	Ten Years	Since Inception[2]
Small Cap Equity	-3.3%	1.2%	0.5%	9.7%	8.8%
Russell 2000 Index	-3.5%	-2.1%	0.5%	7.0%	5.6%
Value Added	**+0.2%**	**+3.3%**	**0.0%**	**+2.7%**	**+3.2%**
Large Cap Value	-3.8%	-0.1%	-3.1%	4.4%	8.2%
Russell 1000 Value Index	-2.2%	3.0%	-2.2%	5.3%	4.9%
Value Added	**-1.6%**	**-3.1%**	**-0.9%**	**-0.9%**	**+3.3%**
Large Cap Growth	-4.6%	8.3%	1.0%	7.3%	7.1%
Russell 1000 Growth Index	-4.0%	5.8%	2.9%	6.0%	0.7%
Value Added	**-0.6%**	**+2.5%**	**-1.9%**	**+1.3%**	**+6.4%**
International Equity	-8.4%	-10.6%	-3.2%	N/A	-1.2%
MSCI AC World ex US Index[3]	-7.6%	-14.6%	-4.4%	N/A	-1.9%
Value Added	**-0.8%**	**+4.0%**	**+1.2%**	**N/A**	**+0.7%**

[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 -3.3% during the quarter, which outperformed its benchmark, the Russell 2000 Index by 0.2%. During the quarter, an overweight to the healthcare sector added value but was partially offset by weak stock selection in the financial sector.

In the technology sector, the portfolio benefitted when a leading business commerce network provider agreed to be acquired at a significant premium. In addition, our investment in the rental housing software industry outperformed as the rental housing market continued to flourish. In the consumer staples sector, our investment in the heart healthy food industry benefitted as it diversified by expanding into the gluten-free market. In the financial sector, our underweight to Real Estate Investment Trusts detracted value. We believe yield hungry investors have pushed REIT prices to unsustainable levels and we do not plan to chase REIT stocks.

During the quarter we reduced our exposure to the healthcare and telecommunication sectors and increased our investments in the technology and industrial sectors. We took profits in three companies in the healthcare, technology and telecommunication sectors that had been acquired and sold a few other investments that had not performed as expected. We reinvested the proceeds in communications equipment, application software, aircraft and employment service industries. We also repositioned our consumer discretionary sector investments out of publishing and into the for-profit education industry.

Large Cap Value

High Pointe's Large Cap Value strategy produced a return of -3.8%, which trailed its benchmark, the Russell 1000 Value Index by 1.6%. During the quarter, stock selection in the healthcare sector added value but was offset by weak stock selection in the financial sector and an overweight to the technology sector.

In the healthcare sector, our investments in the biotechnology and pharmaceutical industry outperformed as their drug pipelines progressed. In contrast, our investment in the banking industry struggled because of losses on trading activity. In addition, our data storage industry investment underperformed as economic forecasts deteriorated.

During the quarter we only made a few adjustments as we believe our current holdings are considerably undervalued. We sold a credit card processor that performed well by adapting to regulatory changes and invested the proceeds in a leading oil and gas company.

Large Cap Growth

High Pointe's Large Cap Growth strategy produced a return of -4.6%, lagging its benchmark, the Russell 1000 Growth Index by 0.6% for the quarter. Our portfolio benefitted from strong stock selection in the consumer discretionary sector but was offset by weak security selection in the technology and energy sectors.

In the consumer discretionary sector, our media investment outperformed as it decided to break up the company to unlock shareholder value. In addition, our broadcasting industry investments benefitted from strong advertising revenue growth. However, our communications equipment industry investment suffered as it lowered growth forecasts because of supply issues. We are maintaining this investment because we believe the long-term growth outlook is strong.

During the quarter we increased our investments in the healthcare and consumer discretionary sectors and reduced our allocation to the industrial and technology sectors. We sold a global positioning industry investment that had performed well because of strong infrastructure spending and a defense company that struggled with government budget cuts. We invested the proceeds in the high-quality jewelry and watch industries. In addition, we repositioned our healthcare sector investments into the biotechnology and pharmaceutical industries.

International Equity
High Pointe's International Equity strategy produced a return of -8.4%, trailing the MSCI All Country World ex-US Index by 0.8% for the quarter.

Over the quarter, our European pharmaceutical industry holdings performed well as investors sought stable companies and as drugs in the pipeline made progress towards potential approval. However, our investment in European banking struggled and an auto industry stock declined in the face of economic growth concerns.

During the quarter we increased our holdings in the healthcare and consumer staples sectors and reduced our investments in the technology and financial sectors. We sold a Chinese internet gaming company that had performed well. We also reduced our mining and fertilizer industry holdings and invested the proceeds in the chemical industry. In addition, we increased our investments in the European pharmaceutical industry.

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We are cautiously excited about the opportunities being presented to us as the European crisis unfolds. We believe a commitment to high quality equities will look like a smart decision when we look back a few years from now. Thank you for your trust and confidence in our ability to add value in managing your assets!