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High Pointe

DATE: October 18, 2013
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

The Chicago Connection

Two notable events occurred in Chicago last week. One, the Chicago Marathon was run in record course time, and only 20 seconds off the world record time. Secondly, Eugene Fama of the University of Chicago was named one of the three winners of the Nobel Prize in Economics. Investment lessons follow from both of these events.

Two people I know very well participated in the Chicago Marathon. One is a 19-year old athlete. He broke his previous best record by an astonishing 23 minutes and finished in less than three hours. The second is a 50-year old who started running only five years ago. This was his first marathon and he finished in a little over five hours. So, what can investors learn from these two marathon runners who are obviously very different from each other.

First, the runners had personalized goals. The 19-year old wanted to qualify for the Boston Marathon which requires a time under 3 hours and 5 minutes, and the 50-year old wanted to complete the race without injuring himself. Analogously, young investors should have a goal of growing their savings through risk taking, while older investors should look for a combination of growth, income and capital preservation.

The 19-year old worked with his college coach to design a game plan focused on maintaining speed while the 50-year old's worked with a trainer to design a game plan that included strengthening his core. For investors, designing a game plan typically means working with a trusted adviser to develop an asset allocation policy based on their investment time horizon, cash flow needs and risk tolerance.

Once the game plan was in place, the runners had to have the mental discipline to get out of bed in the wee hours of the morning and lace up their shoes regardless of rain or shine. The same level of discipline is needed from investors. They need to stay true to their asset allocation policy regardless of the stock market's ups and downs.

Once the runners had their game plan and mental discipline, they had to put in the hours. There is no substitute for this investment of time. Marathon running requires long hours, repetition and experience. Investing also requires time and effort to gain the knowledge and experience that are needed for success.

A successful marathon runner runs his own race and is not influenced by what others are doing. The two top Americans in the Chicago race failed to achieve their personal goals because they got carried away trying to keep up with the Kenyans who set a blistering pace. In a similar vein, investors must avoid following the herd if cold, hard data regarding corporate earnings and valuation point in a different direction. One of the most memorable cases of investors getting burned by the herd mentality was during the Internet bubble; but, there are many more cases such as investors' chasing of REITs, oil and gas limited partnerships and utility stocks in recent quarters.

The sport of running has become quite scientific. Both runners had specific rules for maintaining their calorie intake at 150 calories per hour, precisely timing their eating of GU energy gels, hydrating at exact intervals, and for the 50-year old, maintaining his run-walk ratio at exactly 9 to 1. Similarly, investing has become more scientific over the years. You need the right tools to sift through mountains of information, the right quantitative models to value assets, and you have to rebalance even when it is emotionally difficult.

So, all things considered, successful investing and marathon running have two major traits in common. One, they both require a focus on the long-term goals and avoidance of short-term distractions. Secondly, both have evolved into logical, scientific processes rather than actions based on natural talent and ability.

Now, let's talk about the other Chicago connection. Eugene Fama of the University of Chicago is a co-winner of this year's Nobel Prize along with Robert Shiller of Yale University and Lars Peter Hansen, also of the University of Chicago. Fama is best known for his championing of the Efficient Market Hypothesis which says that predicting stock price movement over the short-term is virtually impossible because any new information about companies gets built into their prices very quickly. Shiller's work, on the other hand, demonstrates stock prices have shown a tendency to deviate substantially from their fair value. This deviation has provided investors opportunities to beat the market if they were willing to take the long-term view and focus on valuation. Taking these two views together implies that in order to succeed in the investing world, it is imperative to focus on the long-run and avoid short-run distractions.

At High Pointe, that is indeed what we attempt to do. We identify investments that are undervalued based on applying our own scientific tools, models and processes. We also focus on long-term trends that impact the franchise quality of companies rather than the chase of quarterly earnings targets.

The trainer/coach of my 50-year old marathon runner friend completed his own run at the Chicago Marathon, then ran back to join my friend, and helped him complete the race by running side by side with him the rest of the way. I don't know if I will physically complete the Chicago Marathon, but I am happy to be running the investing marathon with my clients on a daily basis.

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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 September 30, 2013

	One Quarter	One Year	Five Years	Since Inception[2]
Small Cap Equity	11.5%	28.9%	15.6%	10.0%
Russell 2000 Index	10.2%	30.1%	11.2%	7.3%
Large Cap Growth	5.6%	15.9%	10.8%	8.0%
Russell 1000 Growth Index	8.1%	19.3%	12.1%	2.3%
Large Cap Value	5.8%	24.1%	11.2%	9.4%
Russell 1000 Value Index	3.9%	22.3%	8.9%	6.3%
International Equity	10.0%	17.9%	9.1%	2.7%
MSCI AC World ex US Index[3]	10.1%	16.5%	6.4%	1.8%

[1]Performance for the latest quarter is preliminary and subject to change.
[2]Inception Dates: Small Cap – January 1, 1998; Large Cap Growth – August 1, 1999; Large Cap Value - January 1, 1998; 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 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 **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 **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 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 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 Index is comprised of 1,000 of the largest capitalized companies that are traded in the United States. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group. 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 Equity

High Pointe's Small Cap Equity strategy produced a return of 11.5% during the quarter, exceeding its benchmark, the Russell 2000 Index by 1.3%. During the quarter, stock selection was strong in the technology and financial sectors but was partially offset by weak stock selection in the healthcare sector.

In the technology sector, the portfolio benefitted when an internet software company agreed to be acquired at a significant premium. In addition, our software industry holding performed well with strong growth in bookings. In the consumer discretionary sector, our investment in the auction industry performed well because of activist shareholder involvement. In the consumer staples sector, our holding executed well because of the increasing popularity of its gluten-free offerings.

During the quarter we increased our investments in the healthcare and financial sectors and reduced our allocation to the consumer discretionary and materials sectors. We sold a fertilizer producer when a cartel of suppliers broke up. We also repositioned our oil and gas shipping investments to avoid litigation uncertainty. We invested the proceeds in the residential REIT, healthcare service and facility industries.

Large Cap Growth

High Pointe's Large Cap Growth strategy produced a return of 5.6% compared to 8.1% for the benchmark, the Russell 1000 Growth Index. During the quarter, stock selection in the technology and energy sectors detracted value but was partially offset by strong stock selection in the materials sector.

In the systems software and computer hardware industries, our holdings suffered from slower growth in billings and turnaround delays. In the consumer discretionary sector, our investment in the cruise line industry had to offer lower prices to counter negative news headlines. In addition, our aerospace industry investment was negatively impacted by higher costs. On the positive side, our investment in the biotechnology industry performed well from drug pipeline progression.

During the quarter we increased our investments in the industrial and healthcare sectors and reduced our exposure to the consumer discretionary sector. Specifically, we reduced our holdings in retail industries such as automotive, watches and fine jewelry. We repositioned our technology investments into outsourced services and software. In addition, we reallocated our healthcare investments into medical equipment and managed care.

Large Cap Value

High Pointe's Large Cap Value strategy produced a return of 5.8%, outperforming its benchmark, the Russell 1000 Value Index by 1.9%. Security selection was strong during the quarter with the energy and financial sectors adding the most value.

In the energy sector, our investment in the oil and gas service industry executed well with strong profitability and plans to return cash to shareholders. In addition, our integrated oil and gas holding benefitted from production growth. In the computer hardware industry, our investment performed well with a successful product launch.

We increased our investments in the technology and consumer discretionary sectors and correspondingly decreased our holdings in the healthcare and industrial sectors. We realized profits in companies that had performed well in the cable, pharmaceutical and oil and gas exploration industries. The proceeds were reinvested in luxury accessories, pharmaceutical and semiconductor industries. We also repositioned our automobile industry investments out of auto parts and into manufacturing.

International Equity
High Pointe's International Equity strategy produced a return of 10.0% compared to 10.1% for its benchmark, the MSCI All Country World ex-US Index.

Our German construction industry holding performed well because of restructuring efforts. In addition, our United Kingdom banking investment benefitted from improving capital and earnings outlooks. In the automotive industry, our German investment executed well with strong sales. However, our investment in the Canadian fertilizer industry struggled when a cartel of suppliers broke up.

During the quarter, we increased our holdings in the consumer staples and energy sectors and reduced our investments in the materials sector. We also decreased our Japanese holdings and invested the proceeds in emerging markets. Specifically, we sold investments in the consulting, hotel, fertilizer and gold industries. We invested the proceeds in the tobacco, household products, airlines and credit card processing industries. In addition, we repositioned our automobile manufacturing, pharmaceutical and construction industry holdings.

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Thank you for having us as a coach and a running partner in your investing marathon. We will report to you again how we are doing at the next mile marker in January 2014.