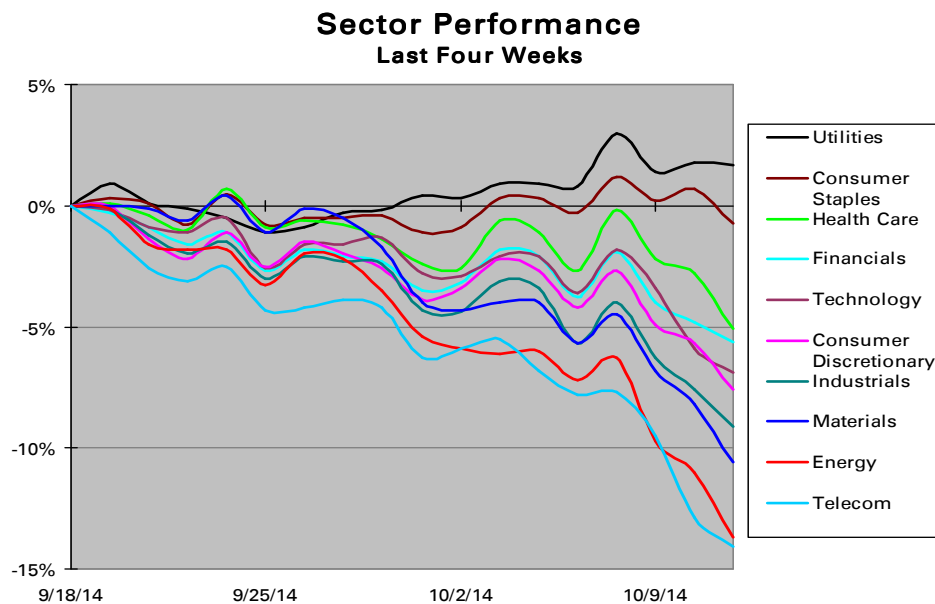


DATE: October 15, 2014
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

Your Portfolio's GPS

The calmness of the stock market has evaporated. VIX, a measure of perceived risk in the stock market, has jumped from a serene reading of 12 to a somewhat turbulent reading of 24 in just the last four weeks. Small Cap stocks have taken it on the chin, declining 10% and large cap stocks have also retreated by about 5%. The fallout is more severe in cyclical sectors such as Energy, Materials and Industrials, and less severe in noncyclical sectors such as Utilities and Consumer Staples as shown in the graph below.



These developments have caused some alarm as evidenced by the \$8.2 billion withdrawal by investors from U.S. equity mutual funds in the last four weeks. What, if anything, should you do in response to these developments? **The answer is that if you have a well-planned, diversified portfolio, you do not need to take any drastic actions, but you may be well-served by fine tuning your portfolio.**

First, let's take stock of how "normal" this correction is. It turns out that five percent corrections in the stock market are quite commonplace. Since the beginning of 2010, even as the S&P Index has rocketed higher by 65% (excluding dividends), it has experienced 22 corrections of 5% from nearby peaks. That is more than four times a year!

The next level of comfort should come from portfolio diversification. It is accepted almost universally that diversification is as an essential component of rational investing. However, few investors truly understand why diversification works, when it might not work, and the extent to which one should actively tweak a well-diversified portfolio. With the help of three simple examples below, we provide some useful guidance regarding active management of a diversified portfolio, especially during turbulent times.

Example 1: Simple Diversification

An investor has an opportunity to invest in two hypothetical companies, Company A and Company B and creates a diversified portfolio by investing 50% in each company. He views their prospects as equally good and expects them to provide a return of 10% per year on average. For illustration purposes, we assume that the two companies are negatively correlated, i.e., when one performs well, the other performs poorly, and vice-versa. In this scenario, the return of individual companies and the diversified portfolio are shown below.

	Value at Beginning of Year 1	Year 1 Return	Value at End of Year 1	Year 2 Return	Value at End of Year 2	Cumulative Return
Company A	\$50	+25.0%	\$62.50	-3.2%	\$60.50	+21.0%
Company B	\$50	-3.2%	\$48.40	+25.0%	\$60.50	+21.0%
Diversified Portfolio	\$100	+10.9%	\$110.90	+9.1%	\$121.00	+21.0%

This analysis shows that **diversification reduces portfolio volatility** by smoothing out calendar year returns but the overall return for the portfolio is the same as that of the two companies.

Example 2 –Diversification with Rebalancing

Now let's see what happens if the investor rebalances the portfolio at the end of the first year back to the 50/50 mix by selling some of the appreciated asset (Company A) and buying more of the depreciated asset (Company B).

	Value at Beginning of Year 1	Year 1 Return	Value at End of Year 1	Buy (+) / Sell (-)	Year 2 Return	Value at End of Year 2	Cumulative Return
Company A	\$50	+25.0%	\$62.50	-\$7.05	-3.2%	\$53.68	+21.0%
Company B	\$50	-3.2%	\$48.40	+\$7.05	+25.0%	\$69.31	+21.0%
Diversified Portfolio	\$100	+10.9%	\$110.90		+10.9%	\$122.99	+23.0%

Voila! Now, the diversified portfolio has generated a return of 23%, a full two percentage points better than the return of either of the underlying securities. **Active rebalancing helps realize the full value from diversification.**

Example 3 – Appreciating Volatility

Now for the last example. Let's say there are two other companies, Company C and Company D, which also produce a 10% average compound return but are much more volatile than Company A and B from Example 2. The table below shows what happens in this case.

	Value at Beginning of Year 1	Year 1 Return	Value at End of Year 1	Buy (+) / Sell (-)	Year 2 Return	Value at End of Year 2	Cumulative Return
Company C	\$50	+40.0%	\$70.00	-\$13.40	-13.6%	\$79.24	+21.0%
Company D	\$50	-13.6%	\$43.20	+13.40	+40.0%	\$48.92	+21.0%
Diversified Portfolio	\$100	+13.2%	\$113.20		+13.2%	\$128.16	+28.2%

The value added from diversification is considerably higher in this scenario as the diversified portfolio earns a return of 28.2% rather than the 23.0% return earned in Example 2. **Volatility, although uncomfortable, creates opportunity. It is reasonable to manage volatility at the portfolio level, but it is also important to understand and take advantage of volatility at the individual security level.**

High Pointe's View on Current Opportunities

Our view at High Pointe is that noncyclical sectors are generally fully valued and as such they are underrepresented in our portfolios. By contrast, values are becoming attractive in cyclical areas and that is where we are focusing our research efforts to find attractive investment opportunities. This line of thinking is consistent with the examples given above as we seek to "rebalance" our portfolio by "taking advantage of the volatility" experienced by individual stocks in cyclical industries.

As we reposition the portfolios, we will be cognizant of the tax implications for our taxable investors. Over the last few years, the importance of taking taxes into account for investment decision making has increased because of the increase in tax rates. Our goal is to minimize your tax burden by making sure that most of the gains are of the low tax variety, i.e., long-term capital gains and dividends. We are succeeding in achieving this goal. For example, in our four Limited Partnerships, these tax-friendly gains comprise about 88% of the total realized gains in 2014.

In Summary

As we think about investing and positioning our clients' portfolios, we find similarities in what we do to the functioning of a GPS system in a car. The GPS systems starts with a destination in mind, comes up with a well designed plan to reach the destination, stays calm if the car goes off course, and takes corrective action. In a similar vein, our management of portfolios starts with a risk-return goal, followed by a well designed portfolio to achieve that goal. We stay calm as market turbulence causes security prices to go off-course, and then rebalance or take corrective action with portfolio changes to take advantage of the opportunities.

But we are more than your GPS. We know your destination and we are honored to be driving your car (portfolio) so you can enjoy the vistas!

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, 2014

	One Quarter	One Year	Three Years	Since Inception ²
Small Cap Equity	-9.0%	0.4%	18.7%	9.4%
Russell 2000 Index	-7.4%	3.9%	21.2%	7.1%
Large Cap Growth	1.0%	21.7%	23.1%	8.9%
Russell 1000 Growth Index	1.5%	19.2%	22.4%	3.4%
Large Cap Value	0.4%	22.8%	25.0%	10.2%
Russell 1000 Value Index	-0.2%	18.9%	23.9%	7.0%
International Equity	-4.5%	9.0%	15.6%	3.5%
MSCI AC World ex US Index ³	-5.3%	4.8%	11.8%	2.1%

¹Performance for the latest quarter is preliminary and subject to change.

²Inception Dates: Small Cap – January 1, 1998; Large Cap Growth – August 1, 1999; Large Cap Value – January 1, 1998; International Equity – December 31, 2006.

³Gross 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 45 countries (22 developed and 23 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 -9.0% during the quarter, lagging its benchmark, the Russell 2000 Index by 1.6%. During the quarter, stock selection was weak in the technology and material sectors, but was partially offset by strong security selection in the consumer discretionary sector.

In the technology sector, our investment in the subscription revenue management business is suffering temporarily during its transition to a cloud-based business model. In addition, our investment in the electrical components industry struggled as its largest customer experienced a sales slowdown. In the material sector, our agricultural chemical investment suffered as its weather related weakness from the previous quarter was compounded by an incorrect booking of a sales deal. All three of these investments have significant rebound potential and, therefore, they continue to be in our portfolios. On the positive side, our investment in the leisure industry made a strategic acquisition that increases its already dominant market power.

During the quarter we increased our investments in the industrial and healthcare sectors and decreased our investments in the consumer discretionary and energy sectors. In the consumer discretionary sector, we sold an auto industry investment that appreciated significantly as demand was strong for its heated and climate controlled seats. In addition, we sold an online photo company that performed well as it explored a buyout and a fitness center that struggled with competition but regained some lost value as investors' liked its REIT conversion plan. The proceeds were reinvested in the life sciences, consulting and electrical component industries.

Large Cap Growth

High Pointe's Large Cap Growth strategy produced a return of 1.0%, trailing its benchmark, the Russell 1000 Growth Index by 0.5%. During the quarter, strong stock selection in the industrial sector added value, but was more than offset by weak security selection in the healthcare sector.

In the software industry, our holding benefitted from solid execution and management's focus on higher growth segments. Our investment in the home improvement retail industry also performed well in a favorable housing environment. However, our investment in the agricultural industry suffered as lower commodity prices raised concerns about the profitability of the agricultural sector. In addition, our investment in automotive retail struggled with weak used car demand.

During the quarter we increased our investments in the consumer discretionary and technology sectors and reduced our investments in the healthcare and energy sectors. In the healthcare sector, we reduced our investments in the biotechnology industry by selling companies that had performed well with strong drug sales and pipeline progression. In the financial sector, we repositioned our asset management holdings out of a company that had performed well and met our price target and into a company poised to benefit from the growth of ETFs and passive investing. In the consumer discretionary sector we increased our investments in home furnishing, auto parts and discount apparel industries with proceeds from the sale of restaurants and movie industry investments. We also reallocated our material sector holdings out of mining and into the industrial gas industry.

Large Cap Value

High Pointe's Large Cap Value strategy produced a return of 0.4%, outperforming its benchmark, the Russell 1000 Value Index by 0.6%. During the quarter, security selection was strong in the consumer discretionary and technology sectors.

In the technology sector, our investments in the semiconductor industry performed well with strong growth and profitability. In addition, our technology hardware industry investment benefitted from favorable product launches. Our investment in the financial service industry agreed to a legal settlement resolving an overhang on the stock. However, our investments in oil and gas exploration and drilling industries struggled because of declining oil prices.

During the quarter, we decreased our investments in the energy, technology and healthcare sectors and increased our investments in the consumer staples and industrial sectors. In the technology sector, we reduced our investments in the semiconductor and software industries. We also took profits in our auto part industry investment as it agreed to be acquired at a premium. We invested the proceeds in the drug retail, super center, asset management, farm machinery and building product industries.

International Equity

High Pointe's International Equity strategy produced a return of -4.5% outperforming its benchmark, the MSCI All Country World ex-US Index, by 0.8%. During the quarter, stock selection in the telecommunication and technology sectors added value but was partially offset by weak stock selection in the industrial sector.

Our Canadian railroad industry holding continued its record of strong execution, benefitting from a robust environment. In the telecommunication sector, our investment in the Mexican market rallied after it sold assets to reduce regulatory pressure. In addition, our Korean telecom investment performed well on increased customers demand for more data. In the automobile industry our Indian investment profited from strong demand for its luxury car models and improved sentiment in the Indian stock market. On the other hand, our investment in the European logistic industry reduced profit forecasts in the face of strong competition and a weak economic environment.

During the quarter, we increased our holdings in the consumer discretionary sector and decreased our investments in the energy and industrial sectors. We also repositioned some investments out of continental Europe and into Japan. Specifically, we sold a Netherlands based internet service provider with connections to Russia as risks increased. In addition, we reduced our investments in emerging markets oil and gas and correspondingly increased our investments in the Japanese auto industry.