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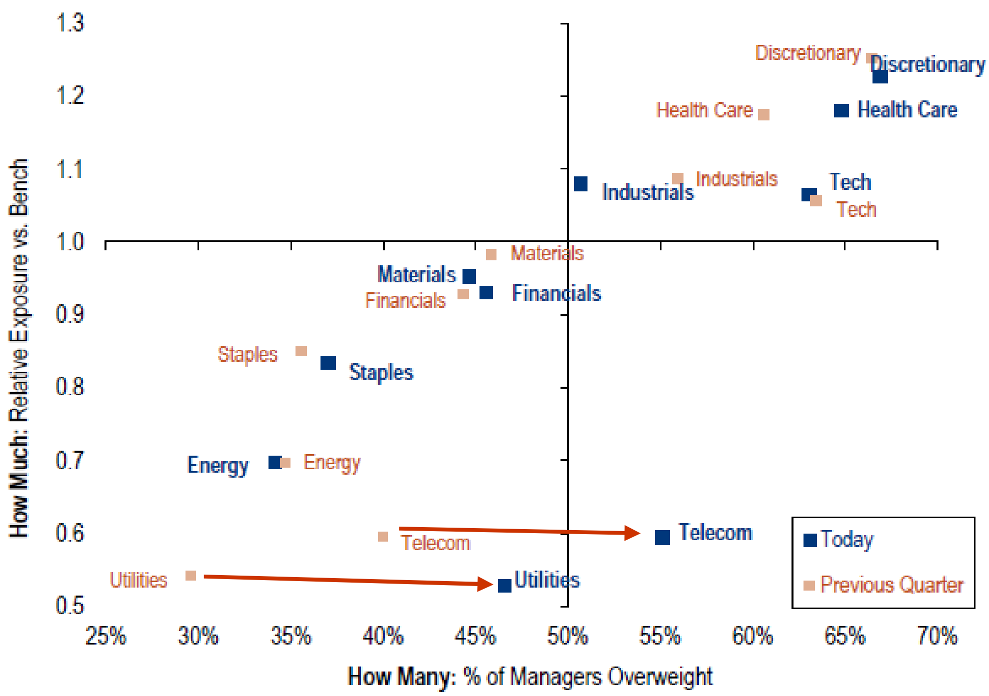
High Pointe

DATE: April 14, 2015
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

The Second Tier

Do you want to peer into the minds of professional money managers? The chart below can help.

This chart from Merrill Lynch shows the portfolio positioning of money managers sector by sector relative to the S&P 500 Index. The vertical axis shows the magnitude by which they overweighted or underweighted a sector. For example, a reading of 1.2 for Health Care implies a 20% overweight to that sector. The horizontal axis shows the proportion of managers that underweighted or overweighted each sector. The blue squares reflect March 31, 2015 positioning and the red squares reflect December 31, 2014 data. A comparison of the data from the two dates enables us to see how managers shifted their portfolios over the last three months.



Source: BofA Merrill Lynch US Equity & US Quant Strategy, Lionshares

Note: How many: % of funds that have an overweight position in the sector; How much: Relative weight to the benchmark (1 = Neutral)

Source: *Why they did what they did: 1Q 15*, a publication by Bank of America Merrill Lynch dated April 6, 2015

Key observations from this chart are as follows.

- Managers clearly favor (Consumer) Discretionary and Health Care stocks and disdain Energy, Utilities and Telecom stocks.

- A dramatic change took place last quarter as a significant *proportion* of managers who were previously underweighted in Utilities and Telecom decided to eliminate the underweighting.

- However, the *magnitude* of the underweight to Utilities and Telecom (shown on vertical axis) did not change. That means that the managers who had previously overweighted these sectors took some money off the table, and reduced their overweight position.

The appeal of Utilities and Telecom stocks is derived from their two key characteristics, namely:

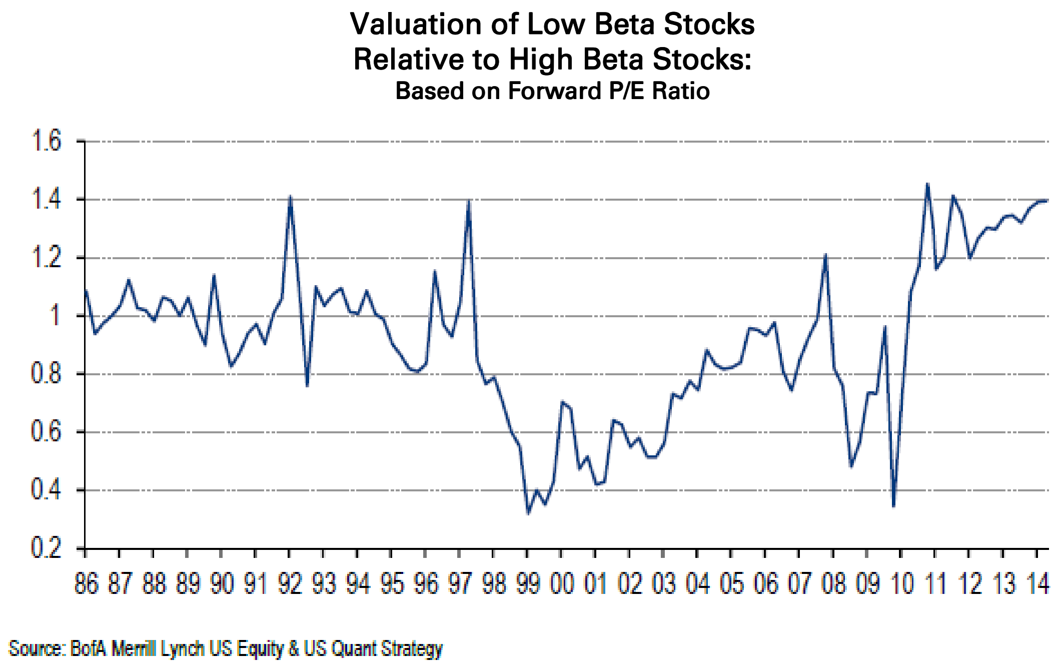
- High dividend yield, and
- Low volatility (measured sometimes by a metric called "beta").

Both of these characteristics deserve a brief discussion in the context of designing a sound investment strategy for the near future.

High Dividend Yield
Favoring certain stocks primarily because of their high dividend yield is clearly fraught with risk as it ignores the likely low growth and occasional high valuation or high risk of such stocks. A better alternative is to focus on stocks with moderate current dividend yield with reasonable valuations and higher growth prospects.

Low Volatility
The low volatility anomaly of investing has been well researched and documented by academics and practitioners alike. As described in our client letter entitled *Tastes Great, Less Filling* published three years ago, lower volatility stocks have counter-intuitively outperformed higher volatility stocks.

This research became well known over the last decade and has led to the creation of many investment products, including exchange-traded funds, which attempt to exploit this anomaly. As more money rides this bandwagon, its success sows the seeds of its own destruction because there is a logical limit to how much money an anomaly can withstand. In our opinion, it is a question of when, not if, this strategy will falter. In a related vein, this strategy's future effectiveness will likely be limited by the fact that current valuations of low volatility stocks are quite high as shown in the graph on the next page.



Source: *Why they did what they did: 1Q 15*, a publication by Bank of America Merrill Lynch dated April 6, 2015

This graph shows that low risk stocks are selling at valuations that are near their 30-year highs. Is it possible for these stocks to continue to perform well and, in doing so, become even more expensive then they are today? The answer is yes, it is possible under at least one specific scenario.

In this scenario, U.S. economic growth slows down considerably, and our Treasury yields decline in the same fashion as their European counterparts have in recent months. Right now the gap between U.S. and European yields is quite high. For example, our 10-year Treasury yield is about 2.0 percent whereas equivalent German bond yields are only 0.2 percent. A large decline in our Treasury yields could further boost the appeal of high dividend, low volatility stocks. A scenario like this is plausible because growth worldwide continues to be weak despite unprecedented stimulus from the central bankers.

Sound investing right now requires a balance between being prepared for a low growth environment and not overpaying for stocks that are the right stocks for such an environment, according to conventional wisdom. We, at High Pointe, are searching for stocks in the second tier of dividend yield that are not yet on the radar screen of yield-hungry investors and, therefore, have reasonable valuations and better growth prospects.

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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 March 31, 2015

	One Quarter	One Year	Three Years	Since Inception[2]
Large Cap Value	-1.0%	10.5%	17.3%	10.1%
Russell 1000 Value Index	-0.7%	9.3%	16.4%	7.0%
Large Cap Growth	3.6%	15.5%	15.9%	9.2%
Russell 1000 Growth Index	3.8%	16.1%	16.3%	3.8%
Small Cap Equity	-2.0%	0.0%	11.4%	9.6%
Russell 2000 Index	4.3%	8.2%	16.3%	7.7%
International Equity	3.4%	-1.1%	8.4%	3.2%
MSCI AC World ex US Index[3]	3.5%	-1.0%	6.4%	1.9%
Global Opportunity	1.6%	4.1%	n/a	10.0%
MSCI AC World Index	2.3%	5.4%	n/a	9.4%

[1]Performance for the latest quarter is preliminary and subject to change.
[2]Inception Dates: Large Cap Value – January 1, 1998; Large Cap Growth – August 1, 1999; Small Cap - January 1, 1998; International Equity – December 31, 2006; Global Opportunity: October 1, 2013.
[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 any portfolio 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 **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 **Small Cap Equity** composite is comprised of portfolios invested primarily in stocks of companies with market capitalization of less than $4 billion. 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. The **Global Opportunity** composite invests opportunistically in foreign and domestic companies 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 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 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. 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). The **MSCI All Country World Index** measures the equity market performance of world's developed and emerging markets including the U.S. Currently the index consisted of 46 countries (23 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
Large Cap Value
High Pointe's Large Cap Value strategy produced a return of -1.0%, lagging its benchmark, the Russell 1000 Value Index by 0.3%. During the quarter, security selection was strong in the Industrials and Health Care sectors, but was more than offset by weak stock selection in the Consumer Discretionary and Financials sectors.

In the Industrials sector, our investment in the Employment Services industry performed well with strong execution and growth in a tough economic environment. In addition, our investment in the Building Products industry benefitted as profit expectations rose. In the Health Care sector, our Health Care Equipment industry investment experienced strong demand for new products. However, our investment in the Apparel Retail industry suffered from anemic growth and weakening expectations.

During the quarter, we decreased our investments in the Consumer Staples, Financials and Technology sectors and increased our investments in the Industrials and Consumer Discretionary sectors. We sold our Super Centers industry investment in favor of a discount retailer. In the Technology sector, we repositioned our investments out of Semiconductors and into the Internet Service and Communication Equipment industries. We reduced our Real Estate Services industry investment and invested the proceeds in the Airlines and Marine industries.

Large Cap Growth
High Pointe's Large Cap Growth strategy produced a return of 3.6%, trailing its benchmark, the Russell 1000 Growth Index, by 0.2%. During the quarter, strong stock selection in the Consumer Discretionary and Health Care sectors added value, but was more than offset by weak security selection in the Energy sector.

In the Consumer Discretionary sector, our Apparel Retail investment benefitted from better inventory management and brand turnaround. In addition, our investment in the Home Improvement Retail industry executed well. In the Pharmaceuticals industry, our investment continued its record of favorable acquisitions expanding into a new market segment. However, our investment in the Oil and Gas Equipment industry struggled as drilling slowed.

During the quarter we increased our investments in the Technology sector and reduced our investments in the Energy sector. In the Energy sector, we sold an Oil and Gas Drilling company that struggled in the face of low oil prices. We invested the proceeds in the Semiconductors and Electronic Instruments industries. In the Consumer Discretionary sector, we sold a flooring company that had benefitted from lower material costs and reinvested the proceeds in the Cruise Line industry.

Small Cap Equity
High Pointe's Small Cap Equity strategy produced a return of -2.0% during the quarter, lagging its benchmark, the Russell 2000 Index by 6.3%. During the quarter, stock selection was weak in the Consumer Discretionary, Health Care and Financials sectors.

In the Consumer Discretionary sector, our investment in the Home Improvement Retail industry suffered after being targeted by short sellers. We opted to divest our holding as the risk to reputation was likely to impact customer sales. In addition, our investment in the Apparel Retail industry struggled with a pause in growth after earlier excellent turnaround efforts. We believe the pause in growth is temporary and are maintaining our investment. In the Financials sector, our investment in the foreign exchange brokerage industry required a rescue package after the Swiss government removed its currency peg to the Euro and the Company's clients suffered large losses. On the positive side, our investment in the mortgage software industry continued its strong growth as its industry leading product continues to be in high demand.

During the quarter we increased our investments in the Financials and Technology sectors and decreased our investments in the Industrials, Consumer Staples and Consumer Discretionary sectors. In the Consumer Staples sector, we sold a convenience store operator that had performed well. In the Industrials sector, we reduced our investments in Consulting and Farm Machinery industries. The proceeds were reinvested in the Regional Banking, Asset Management and Application Software industries.

International Equity
High Pointe's International Equity strategy produced a return of 3.4% trailing its benchmark, the MSCI All Country World ex-US Index, by 0.1%. During the quarter, stock selection in the Industrials sector added value but was offset by weak stock selection in the Financials and Technology sectors. An overweight to Consumer Discretionary stocks added value.

Our Swedish Industrials Machinery industry investment performed well with strong execution and synergies from acquisitions. Our other investment in Sweden also outperformed with growth in consumer electronics. In addition, our Automobiles industry investments benefitted from a strong environment, especially for luxury cars. On the other hand, our investments in emerging market banks struggled with a weak environment and low asset quality.

During the quarter, we increased our holdings in the Industrials sector and decreased our investments in the Energy and Consumer Discretionary sectors. We also reduced our allocation to emerging markets and increased our positions in the UK and Japan. In the Financials sector, we reallocated our investments out of the Real Estate Development and Insurance industries and into the Diversified Banks industry. In addition, we reduced our investments in Oil and Gas Drilling industry and increased our investments in Industrials Conglomerates.

Global Opportunity
High Pointe's Global Opportunity strategy produced a return of 1.6%, lagging its benchmark, the MSCI All Country World Index by 0.7%. In the Industrials sector, our investment in the Electrical Component industry benefitted from strong growth in auto parts demand. Our investment in the European Automobile industry executed well. On the other hand, our Semiconductor industry investment struggled with lower guidance as it works to upgrade its products.

During the quarter, we increased our investment in the Technology and Industrials sectors and correspondingly decreased our investments in the Financials and Health Care sectors. We also reduced our investments in the Pacific-Basin and increased our investments in Europe.