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Innovate. Deliver.

High Pointe

It Takes Two to Tango

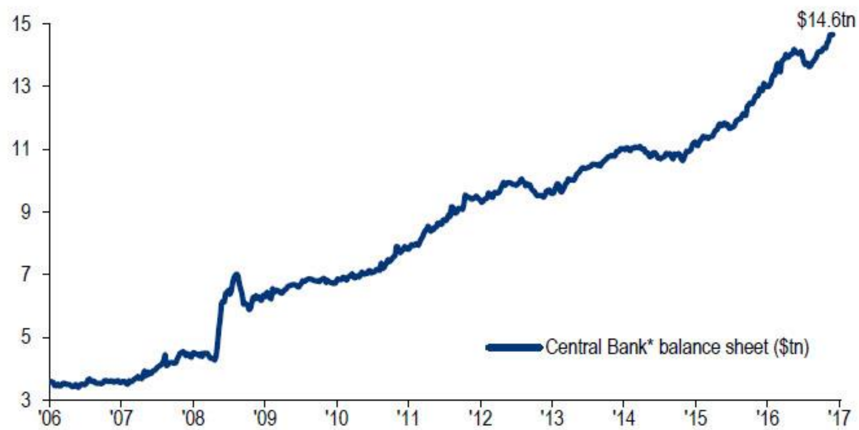
The recent financial headlines of Argentina's sale of 100-year bonds piqued my interest for two reasons. First, considering Argentina has defaulted on its debt eight times in the past 100 years, investors are making quite an optimistic assumption about the country's future relative to its past. Second, it brought back memories of my time as a young investor in the 1990s traveling to Argentina to analyze stocks.

At that time the presidency of Carlos Menem and the policies of his Minister of Economy, Domingo Cavallo, had ignited tremendous investor interest. Pegging the peso to the US dollar and engaging in a major privatization program brought loads of foreign capital into the country as investors were convinced Argentina was on its way to shed its emerging market status and join the ranks of the developed markets. It had put its sordid financial and economic history of the past 100 years squarely behind it. Well, at least for a few years until it went bankrupt and defaulted on its debt yet again in 2001.

Then, as now, investors were embraced in a symbiotic relationship not too dissimilar from the local dance of fame, the tango. They and the government were in an intricate and passionate dance which is euphoric when both parties are in sync but disastrous when one missteps. Today, investors' dance partners are the major central banks of the world. Since the financial crisis of 2008, central banks have stepped in to support the global bond and equity markets. At each step along the way from 2008, they have embraced and led investors in well-coordinated and choreographed moves.

These moves have partially taken the form of an unprecedented amount of asset purchases, both bonds and equities, that continues today despite the current absence of the US Federal Reserve. As the chart below shows, central banks continue to be avid buyers of financial assets in their quest to stabilize the financial system and generate economic growth.

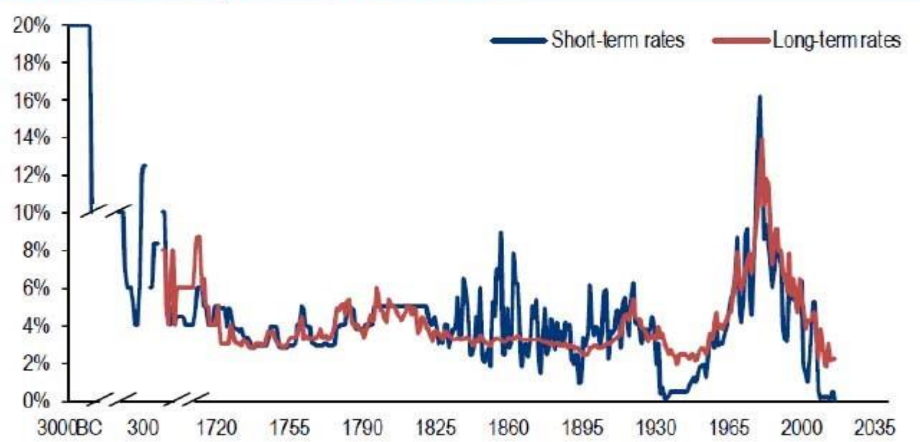
Chart 1: Central banks have bought $1tn in assets YTD



Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg; * ECB + Fed + BoJ + BoE + SNB

This support from the central banks has been an important backdrop for all asset markets. While investors generally think of risk related mainly to the equity markets, we should keep in mind that bonds carry risk too. The chart below shows the unprecedented low level of interest rates that central bank policies have encouraged. It is amidst this artificially low interest rate backdrop that the 7.9% yield on the 100-year Argentine bonds looks enticing to investors.

Chart 8: The 5000-year low in interest rates



Source: BofA Merrill Lynch Global Investment Strategy, Bank of England, Global Financial Data, Homer and Sylla "A History of Interest Rates", (2005)

Interest rates can be broken down into two components: expected inflation and real interest rates. Investors want to be compensated both for the inflation (loss of purchasing power) they expect over the term of their investment and a real rate to compensate them for giving up the use of the money during the time of that investment.

Inflation at this point appears to be subdued for a variety of reasons: slowing total population growth, a decline in the global population of the 24-54 age group (outside of India and Africa) which is the traditional age group that drives consumption, increasing automation and globalization which puts downward pressure on wages, and high global debt levels, among other things.

But real interest rates could rise should global central banks reduce or cease their asset purchases. How much more yield will bond investors demand if there is no central bank willing to buy? A Federal Reserve study in 2012 estimated that an additional $100 billion of overseas purchases of Treasuries lowered interest rates by 0.2%. If this analysis remained applicable to today, reducing the Fed's ownership of bonds by $1 trillion (it is currently at $4.5 trillion) would see real rates rise by 2%. While we are not projecting such an increase in the near future it is easy to see that such a development would be negative for both stock and bond markets.

In light of this, at High Pointe we are paying incremental attention to the fixed income position of our portfolios as well as the potential impact of a rise in interest rates on our equity holdings. As always, we need to plan ahead for any change in the tune of the financial markets.

Chris Olson and Gautam Dhingra
July 20, 2017

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, 2017

	One Quarter	One Year	Five Years	Since Inception[2]
Large Cap Value	1.9%	26.1%	15.3%	10.0%
Russell 1000 Value Index	1.3%	15.5%	13.9%	7.1%
Large Cap Growth	5.0%	26.5%	13.6%	8.9%
Russell 1000 Growth Index	4.7%	20.4%	15.3%	4.6%
International Equity	5.7%	21.8%	7.3%	2.8%
MSCI AC World ex US Index[3]	5.8%	20.5%	7.2%	2.3%
Global Opportunity	3.9%	22.3%	n/a	6.0%
MSCI AC World Index	4.3%	18.8%	n/a	7.5%

[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; 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 **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 **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 46 countries (22 developed and 24emerging 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 47 countries (23 developed and 24emerging 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 generated a return of 1.9%, exceeding its benchmark, the Russell 1000 Value Index, by 0.6%. The portfolio benefitted from strong security selection in the Consumer Discretionary and Telecommunication sectors, but was partially offset by weak stock selection in the Consumer Staples sector.

In the Consumer Discretionary sector, our investment in the Housewares industry performed well with improving margins and cost savings synergies as it integrated a large acquisition. In the Financial sector, our bank holding benefitted from positive stress test results and excess capital. On the other hand, our Energy sector investments struggled because of weak oil prices.

During the quarter, we reduced our investment in the Technology sector and increased our investment in the Industrials and Real Estate sectors. In particular, we sold an investment in the software industry that had performed well with exceptional growth in its cloud business. We also repositioned our investments out of Technology Hardware and Consumer Finance and into Industrial Conglomerates and Office REITs.

Large Cap Growth

High Pointe's Large Cap Growth strategy produced a return of 5.0% for the quarter, outperforming its benchmark, the Russell 1000 Growth Index, by 0.3%. Security selection was strong in the Consumer Discretionary and Technology sectors, but was partially offset by weak stock selection in the Financial sector.

In the Consumer Discretionary sector, our investment in the Direct Marketing Retail industry benefitted from strong execution. Similarly, our Internet Retail holding experienced tremendous revenue growth and looked to capitalize on its scale by expanding its product offerings. In the Financial sector, our investment in the credit card industry faced weakness along with competitors as charge offs increased slightly.

During the quarter, we increased our investment in the Healthcare sector and reduced our investment in the Consumer Discretionary and Financial sectors. We sold a Motorcycle Manufacturer that had struggled with growth and a Brokerage company that had performed well as interest rates firmed up. We reinvested the proceeds in the consulting industry. In addition, we repositioned our Healthcare sector investments in the Pharmaceutical industry.

International Equity

High Pointe's International Equity strategy produced a return of 5.7%, trailing its benchmark, the MSCI All Country World ex-US Index, by 0.1%. Stock selection was strong in the Financial and Materials sectors, but was offset by weak security selection in the Energy sector.

In the Financial sector, our investment in a Pacific life insurer experienced strong growth. Our investment in European Brewers also benefitted from its good execution in the Pacific region. In contrast, our North American Energy investments struggled because of a decline in the price of oil. Our investment in a United Kingdom cable company suffered as capital investment did not generate the growth expected.

During the quarter, we increased our investments in the Real Estate sector and decreased our investments in the Consumer Discretionary and Financial sectors. We also repositioned our investments out of the United Kingdom and emerging markets and into the Pacific region. We sold investments in Japanese and emerging market Automobile Manufacturers, and United Kingdom and emerging market banks. The proceeds were reinvested in Australian Real Estate and North American mining industries.

Global Opportunity

High Pointe's Global Opportunity strategy produced a return of 3.9% during the quarter, lagging its benchmark, the MSCI All Country World Index, by 0.4%. In North America, our internet search investment continued to execute well and generated strong growth. Our investment in a Pacific life insurer also performed well as revenue exceeded expectations. On the other hand, our North American grocery holding struggled as competition increased.

During the quarter, we increased our investments in the Materials and Technology sectors and decreased our investments in the Financial and Consumer Staples sectors. We also reallocated our holdings out of the United Kingdom and Europe and into emerging markets and the Pacific region.

Thank you for entrusting us with the responsibility to manage your investments. We look forward to reporting our progress to you again in October 2017.