

# RIVERPOINT

CAPITAL MANAGEMENT

INVESTMENT ADVISORS

Independence | Integrity | Experience | Communication | Performance

## SHORT-TERM VOLATILITY EMPHASIZES IMPORTANCE OF LONG-TERM FOCUS

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Even a casual market observer could tell you that it’s been a wild ride over the past couple of years. In fact, the Standard & Poor’s 500 Index has experienced a day of plus / minus 2% essentially once per week (every four trading days, to be exact) since the height of the global credit crisis in September, 2008. Compare that pace to the once a month pace over the last 60 years (more specifically, one +/- 2% day every 24 trading days since 1950), and it’s clear why many investors feel that a dose of Dramamine would be more helpful than patience at this point. Every day, it seems like its “crisis” this or “bubble” that - for every pundit calling for a catastrophic double-dip recession there’s another saying that this is the beginning of a monumental bull run for stocks. The volatile market action is creating an atmosphere of extremism. Mix this volatility with vast global uncertainties - economic, political, environmental - and you get an anxious investor base. Throw in the quirky circumstances that exist at the time - super low interest rates AND ridiculously cheap stocks - and you have a recipe for confusion. Top it all off with shot of sensationalism (to sell television ads) and a touch of instant gratification (is any title more appropriate than CNBC’s “Fast Money?”), throw it in the oven for 45 minutes at 350 degrees and you’ll have yourself a lovely “choppy market casserole.”

At RiverPoint, we consciously take a different approach. Call us old-fashioned, but instead of getting caught up in the day-to-day gyrations of the market, we’re maintaining focus on how attractive stocks are looking for the long-term. And by “long-term”, we don’t mean the “just after the commercial break” long-term that pervades the financial press. We’re not referring to the “measuring our return in pennies per share” long-term of the high-frequency trading outfits that seem to run roughshod over the market. At RiverPoint, our long-term means several years - the way investing is meant to be done.

Now, we’re not advocating buying stocks and forgetting about them. While that approach would dramatically improve our work / life balances, it certainly isn’t going to yield good results. Successful

investing requires a concentrated daily focus on company news, industry developments and market moves - in other words, intense daily research. In our research, we focus on company fundamentals and aim to buy high-quality, fundamentally strong companies that are trading at valuation multiples that are, in a word, cheap. Over the long-term, our approach has proven itself to be very successful.

At RiverPoint, our approach is designed to help our clients achieve their investment goals over the next three, five, and ten years. We talk to our clients about their particular financial situation, analyze and determine what mix of stocks and bonds makes sense for them given their income requirements and risk tolerance, and then we get to work finding those cheap blue-chip companies and fixed income securities in which we invest our clients' money.

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However, that's only the beginning of the process. With each stock that we buy, we have specific reasons why we decided to own that stock - it's our job to make sure that the company is meeting expectations. If we buy a stock with the idea that the company is going to invest in new overseas manufacturing plants in order to gain market share in emerging markets, we're not going to get too bent out of shape if its most recent quarterly earnings are a penny short of what Wall Street analysts were expecting. As long as we know that our long-term thesis is intact, we will continue our focused research and maintain that position. In a market atmosphere that's as uncertain as this, day-to-day volatility can make it difficult to maintain focus on the long-term. But in times like these, the importance of a long-term focus is clearer than ever.

It seems that many of the "gloom and doomers" might be out of ammunition. For months now, the biggest questions hanging over the equity markets have been financial reform, health care reform, the health of the Euro Zone, and if Europe's problems will cause another global financial crisis. At this point, we can pretty much check those items off the list.

Financial reform passed, and while it's going to negatively impact profitability, it doesn't look like it will choke the financial sector into submission. Health Care reform also passed, and while the cost of doing business will increase for many firms in the industry it doesn't seem to be the death blow that many had feared.

Europe isn't exactly the picture of good health, but it's not cratering under the weight of all of that troubled debt, either. No country has defaulted or appears to be on the verge of default, and if corporate earnings reports are to be believed then business across the pond isn't that bad. Like the U.S. did several months ago, European central bankers conducted their own "stress tests" on 91 institutions and found that only 7 would be under-capitalized under the worst scenario. Most observers agree that the stress tests weren't very "stressful," but the fact that only 7 banks were deemed "undercapitalized" and a grand total of \$3.5 billion

was needed in order to get them up to snuff is, in our mind, not a disastrous outcome. Of course we'd like to see some more specifics and a more rigorous test done, but even quadrupling or quintupling the amount of capital needed would still leave the European banking system with a manageable figure (meaning that their banking system isn't the disaster area that some had feared).

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Second quarter earnings reports have been encouraging, as well. So far, roughly 2/3 of companies have beat analyst expectations, which is a rate similar to that of the first quarter. Management commentary has been generally upbeat, which is another sign that maybe fears of a “double-dip” have been overdone. Interest rates remain near historical lows, which is generally positive for businesses.

Of course, uncertainty still exists. The housing market appears to have taken a step back following the expiration of the homebuyer's tax credit. Unemployment is still a problem and could impact consumer spending for the foreseeable future. Many investors have thrown in the towel and have retreated from the stock market. These uncertainties are significant and we cannot predict how they will ultimately impact the future.

How do we balance these uncertainties against stock market opportunities caused by very attractive valuations (in the form of low price-to-earnings ratios)? A balanced mix of fixed income securities and equities can position a portfolio for protection against market turbulence (through the income and principal stability of the fixed income securities) and the potential for capital appreciation (through exposure to common stocks). Since early May we have taken a more conservative stance in our “balanced” client portfolios. We have purchased high-quality corporate bonds in our balanced portfolios, in some cases replacing municipal bonds due to concerns over the state of municipal finances.

We believe that the stock market will probably go sideways for a while and our bond holdings will provide stable income and principal protection. With this conservatively balanced approach, we will be able to have a portfolio that can grow in a market recovery but will also be protected in case of another market dip.

	<u>7/29/2010</u>	<u>2010 Price Change</u>
Dow Jones Industrial Average	10,467	0.38%
NASDAQ Composite	2,252	-0.77%
Standard & Poor's 500 Index	1,102	-1.22%