

R I V E R P O I N T R E P O R T

January 29, 2010

SPECIAL EDITION – WHAT TO WATCH FOR IN 2010

We would like to take this opportunity to wish all of our clients and friends a “Happy New Year.” January is always a time of reflection and looking forward. What does the new year hold in store for us? In euphemistic terms, the past two years could be described as “interesting.” A more realistic description of the panicked and highly volatile state of the financial markets would be “stressful,” or even “frightening.” The credit crisis, the “Great Recession,” the entire global financial system seemingly on the brink of collapse – these are events the likes of which we hope never to experience again. Given the current state of affairs in the global economy, we are seeing 2010 as “pleasant,” or even “boring.” Not that we’re complaining...

This special edition of the RiverPoint Report discusses the investing themes that we feel will be important in 2010, along with our plans and strategies for taking advantage of them. To review these topics, we’ve asked Leon Loewenstine, Managing Director and Chief Investment Strategist at RiverPoint, to share his views about 2009 and what he sees in the year ahead.

RiverPoint Report: Generally speaking, what do you expect in 2010?

Leon Loewenstine: Our current outlook is for slow and steady growth. Technically speaking, it appears that the Great Recession came to an end after the second quarter of 2009. Businesses began replenishing bare-bones inventory levels and government stimulus programs drove a slight increase in demand. Productivity improvements over the past few years have allowed companies to ramp up production with fewer employees following widespread layoffs. These factors combined to get global economic growth heading in the right direction, and we see this trend picking up some steam in the coming year. The “BRIC” countries – Brazil, Russia, India and China – are expected to continue to outpace the rest of the world, with the Euro Zone continuing to be the noticeable laggard among developed economies.

We should point out, though, that some cracks are beginning to surface in the China story. More and more reports are detailing exponential increases in real estate prices, how Chinese investors feel the need to “get in while they still can,” how a lot of the increased bank lending is just getting plowed into the already-frothy stock and property markets - these developments are something we are watching closely. Remember, the Chinese economy needs to grow 8% or 9% just to keep unemployment where it is. If the economy slows from its current pace, there would be significant repercussions around the world, particularly in the demand for commodities like fossil fuels and precious metals. A slowdown in Chinese economic growth could also potentially stoke the flames of civil unrest.

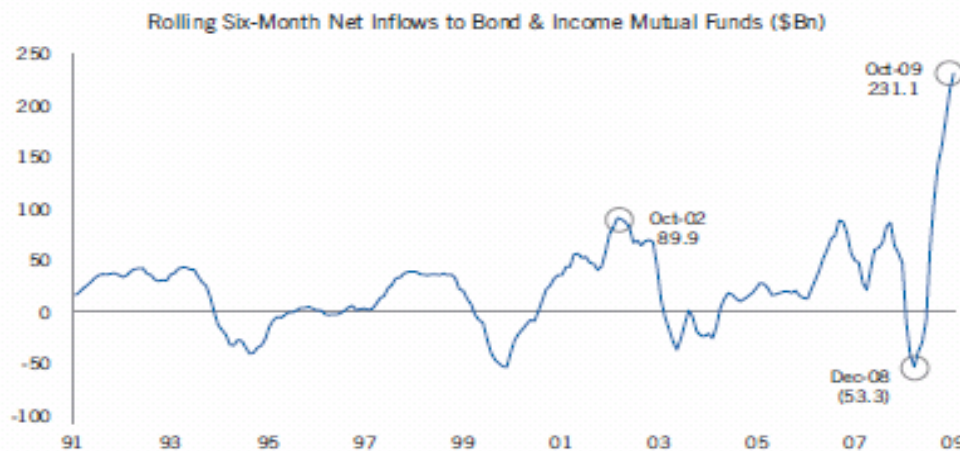
In the U.S., we see positive, yet unspectacular, growth. Unemployment will likely remain elevated due to low capacity utilization rates and increased worker productivity. Interest rates are expected to remain low, especially for the short-term, as the Federal Reserve is committed to its

“low for long” mantra of keeping its benchmark rates low. Inflation, while above zero, should remain manageable as wage increases remain low and credit remains tight as banks continue to be concerned about additional losses from commercial real estate and other corporate loans.

While it appears the housing market has bottomed, we do not look for any significant upturn as long as unemployment remains high and the inventory of unsold homes remains above normal. Commercial real estate will likely get worse during the year as struggling retailers and businesses are unable to renew leases, leading to higher vacancies and lower property values. This weakness could expose banks to a new wave of asset write-downs.

The bottom line is that we see economic growth in the 2%-3% range for 2010. Equities remain attractive on a relative and absolute basis, especially when compared to the paltry yields being offered on bonds, with stocks trading at a reasonable 15 times expected 2010 earnings. At RiverPoint, we view the improved macroeconomic situation and reasonable equity valuations as an opportunity to carefully increase equity exposure towards the mid-point of each client’s equity allocation range. We believe there are many factors that could drive equities up another 12%-15% for the year, such as strong corporate earnings, a pick-up in M&A activity and over \$3 trillion sitting in cash in money market mutual funds that are earning less than 1%. In addition, a good contrarian sign is that money flows into bond funds remain at record levels (see chart below). As we see it, these bond fund inflows were a result of investors feeling uneasy with the condition of the global economy. As 2010 progresses and the global economy continues to stabilize and improve, the expected return and current yield on many of these bond funds will drop and investors will likely look for higher returns in the stock market. Many high quality equities actually pay a dividend that exceeds the yield on their bonds.

Exhibit 21: Bond-fund flows at an all-time peak



Data as of 12/10/09. Source: ICI, MSIM.

Inflation is not a problem in the near-term and interest rates are now very low. That said, there is also reason for caution because of high unemployment, low (albeit increasing) consumer confidence, a struggling housing market and potential problems in commercial real estate. In general, we think the positives will win out for the year and equities will finish 2010 higher by around 12%-15%, however there will likely be pockets of weakness along the way. Within the market, we think stock selection and asset allocation will be critical.

RiverPoint Report: Can you share with us some of the changes you have made recently in your equity portfolios?

Leon Loewenstine: We have taken profits in some stocks that have experienced exceptional price appreciation since the March, 2009 lows. Many stocks, like Mosaic and Ingersoll-Rand, have seen their stock prices really shoot up to a point where the market seems to be assuming a much stronger economic rebound than what we are expecting. We have used the proceeds to add some higher quality companies with lower price-to-earnings ratios with solid growth ahead, companies like Wal-Mart, Comcast and General Dynamics.

These are “blue chip” stocks that didn’t fully participate in the 2009 rally. Many of these stocks offer compelling upside potential with a decent margin of safety built in on the downside due to their low valuations.

RiverPoint Report: What about the sell side? What causes you to sell a stock?

Leon Loewenstine: Two things drive our decision to sell a stock. One is valuation, when the valuation gets excessive relative to our projected growth rate or relative to its historical valuations. When a stock starts to approach, say, a 20% premium to its historical valuation, it’s a signal to us that it is probably time to start scaling back the position or to sell it outright. We are sensitive to portfolio turnover, but when a stock starts to get excessively valued relative to its historical valuation, it is important to be disciplined.

The second reason would be a change in the fundamentals or our outlook for the company or its sector. An example would be the health care industry. Early last year, the potential for dramatic changes in that sector made it difficult to know what the rules were going to be or what impact proposed reform would have on various companies. As a result, we decided to avoid the HMO’s which looked to be the biggest losers under the proposed health care reform. However, we still find several companies in the industry very attractive, such as Teva Pharmaceuticals and Fresenius Medical. Teva is one of the largest generic pharmaceutical companies in the world, based out of Israel. They’ve been growing earnings around 15% a year, yet the stock trades at 13 times earnings. Another interesting health care stock that has worked well recently is Fresenius Medical. It is a German company and is the largest provider of dialysis in the United States. Fresenius should experience increasing demand for its services as the population ages and more people are likely to have health care insurance in the future.

RiverPoint Report: Tell us about your outlook for the international markets and stocks.

Leon Loewenstine: We believe it is important to maintain exposure to the international markets since it is likely that their economies will continue to grow faster than the U.S. economy. I mentioned two attractive international companies, Teva Pharmaceuticals and Fresenius. Other examples of interesting international companies include BHP Billiton, the largest mining company in the world, and Unilever, which has strong exposure to the emerging markets. Generally, we’ll have 10%-20% of our clients’ equities invested in either international companies via American Depository Receipts (ADRs, which are basically an American version of a company’s internationally-traded stock) or through diversified international stock mutual funds like Harbor International Fund or the Matthews Asia Growth & Income fund.

RiverPoint Report: What about dividends? Is that something that you look for?

Leon Loewenstine: Dividends are always an important part of our investment analysis. However, we do not require all companies to pay a dividend because many companies are able to reinvest their cash flow more efficiently internally and grow earnings faster. We believe it is important to have a blend of high quality blue chip stocks that pay and grow their dividend consistently along with a few faster growing companies. This is what diversification is all about.

Over the past 50 or 60 years, dividends accounted for approximately 40% of the total return of the S&P 500. Our opinion is that, looking ahead, dividends are going to become a more important part of total return as stock returns may be a little below their historical average of 10% a year. It wouldn't be surprising to us if, in the next five to ten years, the market returns 8% or 9% per year. Therefore, dividends will be an increasingly important part of those returns. We do not just look at companies that pay dividends though. Granted, if you can find stocks that yield about 3% and can grow their dividends at an 8%-10% rate per year on top of high-single-digit earnings growth, you're looking at an annual return in the 10%-12% range. All things being equal, these kinds of stocks should do better than the broader market over the next couple of years. Thus, we look at dividends hard, but it would be silly for any advisor to take an approach that ignores companies that simply don't pay dividends. If a company can reinvest cash in order to grow earnings, then that makes more sense than using that cash to pay a dividend.

Generally, 70% to 80% of our holdings pay dividends. Over the last 20 or 30 years, we've seen tremendous changes in what works in the market and what has made sense – focusing on dividends, internal earnings growth, growth by acquisition, research & development spending, etc. - and I think our success as a firm is really centered on being flexible and open-minded to opportunities wherever they may be. For clients looking for more attractive dividend opportunities we will structure their investment portfolio to include master limited partnerships (MLPs) and trust preferred stocks, both of which can yield 6%-8%. MLPs are a niche in the market that's only been around for about 10 to 15 years. This area is not followed heavily by Wall Street analysts, leading many investment advisors to ignore it completely. This lack of attention is what presents an opportunity to us. The MLP stocks enjoy favorable tax treatment – the dividends are tax-deferred until sale of the stocks - because Congress wants to encourage investment in energy infrastructure in the U.S. The stocks have consistently beaten the S&P 500 over the past 10-12 years with significantly less volatility.

Another attractive income-producing asset is trust preferred stocks. This is another area ignored by many advisors. The yields are in the 6%-8% range. We tend to focus on liquid issues of higher quality companies like Wells Fargo, Bank of America and other high-quality enterprises that we know are relatively safe. Many of these stocks are up 20%-30% this year. This is just another way we have been able to add a lot of additional value to our client portfolios, particularly for those in retirement who have a greater need for income.

RiverPoint Report: What about the risk control factor? How do you incorporate risk management within your portfolio and individual securities?

Leon Loewenstine: Within the portfolio, we tend to diversify by asset class, sector and position size. In terms of asset classes, client portfolios will include bonds, small and mid-cap stocks, large cap, international, preferred stocks and alternative investments. Within the equity portfolio we limit sector weightings to 35% and individual positions to 5% (excluding special circumstances, like large blocks of low-cost basis stock). Thus, on average, we will hold between 35-45 positions. We also control risk through extensive fundamental analysis and we make sure that the companies we own have strong balance sheets and free cash flow. Financially sound companies are in control of their future; they generate significant free cash flow. This financial

strength means that the company will probably be able to raise capital in the open market on favorable terms and won't be forced to run to a bank for funds that come with a lot of strings attached.

RiverPoint Report: In this age of increased volatility, do you find that you are a more active manager than in the past? Is the old buy-and-hold strategy a thing of the past?

Leon Loewenstine: You know in the 1950s, 1960s and 1970s, you could buy stock in a great company and put it away and forget about it. You could buy companies like General Electric, Merck, Pfizer, Fifth Third Bank, Procter & Gamble and AIG and you could just hold them forever. But recent history has taught us that you can't do that today, as many of the above companies are fighting for survival.

So, yes, our turnover has picked up over the last few years but it is still very reasonable at around 25%-35% per year. A lot of our turnover comes from trimming positions when stock prices have increased faster than earnings have grown. This is an easy discipline to follow and is one of the most logical disciplines in investing. A stock's price cannot continue to rise faster than earnings for a long period of time without setting the stock up for a significant fall.

At RiverPoint, we believe in active management; we believe in being proactive as much as possible and making changes as events are unfolding rather than just standing on the sidelines. To us, this is a critical aspect of active management – this helps us avoid uttering the famous last words of many brokers, “just stay the course.” That's why we take a lot of pride in not having owned any Bear Stearns, Lehman Brothers or Merrill Lynch stock when the crisis hit. Unfortunately, for a lot of investors in 2007 and 2008, their advisors told them to just stand pat and their portfolios lost 40%-50% or more. At RiverPoint, we may not have a perfect crystal ball but we are not afraid to make tough decisions as we try to protect our clients' principal as best we can. This is one reason why we strongly encourage all of our clients to have some fixed income exposure.

CONVERTING A TRADITIONAL IRA TO A ROTH IRA

The weather outside is frightful, but the men and women on Capitol Hill have thrown investors an opportunity that could be delightful. In 2010, legislators are allowing investors to convert a traditional individual retirement account (IRA) to a Roth IRA. This may not sound like a big deal, but depending on the situation, it could be huge. The main difference between a Traditional IRA and a Roth IRA is that the Traditional IRA is funded with pre-tax dollars and requires taxable withdrawals, where the Roth IRA is funded with after-tax dollars and has purely elective, tax-free withdrawals. Any conversion amount will be taxed as ordinary income, so there is an up-front cost associated with this conversion; following is a series of questions to help you determine if converting a Traditional IRA to a Roth IRA makes sense for you.

The first appropriateness hurdle is if you are currently withdrawing funds from your Traditional IRA. If you are taking withdrawals, there may not be a long enough horizon going forward to make up for the up-front cost of the conversion, especially if you are relying upon the withdrawals to pay for living expenses. In other words, the benefits of having tax-free withdrawals in the future likely would not make up for the cost of the conversion penalty, making conversion a poor economic decision. If you are not currently taking withdrawals, or are taking mandatory withdrawals but do not rely upon those funds to pay living expenses, converting your Traditional IRA to a Roth IRA may make sense.

The next question to ask yourself is if you will need the funds in your Traditional IRA during your lifetime. If you will be able to fund your retirement with savings outside of your IRA, converting is a viable option. If you are planning to withdraw less than 4% of your IRA per year to pay for living expenses in retirement, a conversion may still make sense. Those investors that plan to withdraw more than 4%-5% of their IRA balance annually to fund future living expenses may not be able to recoup the initial conversion penalties and should probably not convert their Traditional IRA to a Roth.

Do you expect to be in a higher income tax bracket in the future, or a lower income tax bracket? If you expect to be in a higher income tax bracket in the future, then a conversion holds appeal since you would pay a lower income tax rate now on the conversion amount than you would on future withdrawals. If you expect to pay lower income taxes in the future, then it doesn't make financial sense to pay the government a conversion tax at a higher rate than that which you would pay on future withdrawals.

Right now, those of you who aren't planning on using your Traditional IRAs during your lifetime or are only planning on using a small portion of the funds for retirement, and also expect to be in a higher income tax bracket in the future are still candidates for conversion. The final question to be asked is if you have sufficient funds outside of the IRA to pay for the IRA conversion.

If you have the ability to pay the conversion tax with non-IRA funds, then you should strongly consider converting all or part of your Traditional IRA to a Roth IRA. If you would need to pay for the conversion penalty with funds from the IRA itself, conversion to a Roth IRA would not make financial sense since the balance of the IRA would shrink by the amount of the conversion penalty (example: for an investor in the 30% income tax bracket converting a \$100,000 IRA would have to withdraw \$30,000 from the IRA in order to cover the conversion tax, reducing the balance of the account and lowering the long-run benefits of the conversion).

By answering the above questions, you should have an idea if converting your Traditional IRA to a Roth IRA makes sense for you. As always, there are some exceptions. The most common of which would be young investors with significant time horizons (15 years or more) and who have non-IRA money available for the conversion penalty; such folks should strongly consider a conversion to a Roth IRA. Clearly, the decision to convert a Traditional IRA to a Roth IRA is highly dependent upon each investor's unique situation. If you have any questions about whether a conversion would make sense for you, call a RiverPoint Capital portfolio manager and they will help guide you through this potentially tricky decision.

“WHAT IS THE DEAL WITH ESTATE TAXES?”

As Jerry Seinfeld would say, “What is the deal with estate taxes? I mean, come on! They're eliminated! They'll be reinstated! Washington will make up their mind later, and apply them retroactively! What do we do about death?!?!” Well, maybe Seinfeld won't address estate taxes in his next stand-up routine, but the point is that no one is quite sure what the situation will be going forward. The confusion stems from the fact that legislators have allowed the estate tax to expire effective January 1, 2010. It is widely expected that current legislature will reinstate the tax that was abolished by the prior administration. In all likelihood, the estate tax framework will look similar to that which was in effect during 2009: \$3.5 million estate exclusion, with \$1 million worth of gift exclusions during one's lifetime. We will monitor this situation closely and pass along details as they become available.

A REMINDER ABOUT INCOME TAXES

For this author, an annual New Year's resolution is to get an early jump on getting my income tax return done as early as possible in order to avoid the last-minute hurrying that seems to plague the process every year. Personally speaking, success in this endeavor has been elusive. However, we would like to remind you that while it is important to begin the tax preparation process early, it is in your best interest to wait until you receive all of your tax forms – 1099 INT, K-1, etc. – prior to submitting them to your accountant. At this point, it may be worthwhile to wait a few more weeks since there are many instances where 1099s or K-1's are corrected or amended; these "revised" versions sometimes don't arrive in the mail until mid-February or early March. Not only will your accountant appreciate your thoroughness, but handing over a complete set of documents at once will reduce the likelihood that something could be overlooked or lost. If you have any questions about what tax forms you need and or should expect to receive, or if you need assistance in preparing your income tax return, please contact one of the portfolio managers at RiverPoint Capital Management and we can answer your question or put you in contact with a qualified CPA.

For information about RiverPoint Capital Management or to view our report archive visit us at <http://www.riverpointcm.com/>.