



PERSPECTIVES

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Talk With Us

Volatility is again the name of the game. Two hundred, three hundred, and even four hundred point days have been all too common. Often, big moves in one direction are reversed in a matter of days with moves in the opposite direction. So what is going on and for how long?

Many investors are on the sidelines waiting for a resolution to the outlook. They cannot determine if the obvious problems in the economy are containable to a few sectors or if new problems will keep surfacing and create a domino cascade into a worse and worse economic environment. Until enough evidence mounts up on one side of the argument or the other, sentiment bounces from relative optimism to abject fear. Throw in a presidential election with all the implications and uncertainties for the future, one can see how traders with relatively light activity can move prices around dramatically.

Evidence so far supports the case for containable and manageable problems. The Federal Reserve, the Treasury Department, and even the executive and legislative branches of our government have been active and creative in their efforts to mitigate problems as they have arisen. The Bear Stearns rescue was controversial, but did arrest a potential cascade of further disasters. Liquidity is being pumped into the financial system as never before and the capability and role of the Fannie Mae and Freddie Mac

is being expanded in the mortgage markets.

Outside of the problem areas, much of the rest of the economy is doing just fine. Exports are booming. Agriculture has not had such favorable conditions and prices for as long as one can remember. Services are holding up and employment is still high.

Much of the rest of the world is also doing fine. Economies are growing, incomes are rising, and demand for resources of all types keeps increasing. The United States' economy represents approximately 25% of the world economy and its relative share keeps falling as the rest of the world grows faster. A modest decline here of even a few percentage points has less and less impact. In fact, China's exports are modestly down, but internal demand and growth are more than picking up the slack. The same is happening in many other places.

So what does all this mean and how is it likely to resolve itself? Of course, no one can ever really know the future, but evidence is mounting. Every good investment strategy ought to have protections and hedges built into its approach; one, after all, has to protect from the unknown or the surprise. At Riverplace Capital, we have done that, but here is what we think is most likely.

Volatility, why does it happen and what does it mean? It happens as a response to major changes in the environment. Investors do not have a model for the future or cannot make a determination as to which among competing outlooks is most likely. So they bounce from one assumption or outlook to another. Heightened volatility can persist for years, as it did from 2000 to 2003.

Volatility may occur with or without high levels of volume or participation by investors. Low volume volatility occurs when traders and other short-term strategies overwhelm normal investment activity. This often happens as many investors retreat to the sidelines to await more data in order to make judgments as to the course of business trends.

High volume volatility often occurs at turning points. It may be a response to fear, usually brought about by some event. An example here is the recent sell-off of markets around the world to the news that Bear Stearns had essentially failed. Many investors first thought that there might be more failures and a collapse of our financial system.

Since the spring of 2007, markets have been quite volatile. This comes after a placid period from about 2003. So we have a clear signal that the environment has changed and we do not yet know what is to come. Most likely, there will be new winners and losers. The losers are becoming

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MAJOR INDICES AS OF 3/31/2008

Large Cap Stocks (S&P 500)	-9.92
Dow Jones Industrial Average	-7.55
Mid Cap Stocks (S&P 400)	-9.17
NASDAQ Composite	-14.07
Small Cap Stocks (Russell 2000)	-10.19
MSCI EAFE	-9.53
Lehman Corp. Bond Index	3.21
Inflation	4.0

(EQUITY INDICES ARE THREE MONTH RETURNS EXCLUDING DIVIDENDS)

Forecast

Economy

Riverplace Capital Management, Inc. believes that the United States will suffer a modest recession. We are probably already in one. It is centered in housing and all its allied parts along with the financial sector and affecting a variety of consumer sectors as well. The duration is likely to take longer than average, but remain shallow. The economy will look increasingly like one made up of haves and have-nots.

The depressed sectors should stay that way for far longer than usual. That is because the previous boom was so extreme that it will simply take longer to unwind the excesses. Problems will linger and there are no quick fixes. Strong sectors, on the other hand, should keep getting stronger. Some of these are coming out of depressed periods that lasted for decades. There are no obvious excesses building here, just catch-up for decades of underinvestment.

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Forecast *(continued)*

Equities

Those companies in troubled sectors are likely to have prolonged difficulties, although periodically, attempts will be made to call a bottom for these stocks and rallies could be dramatic, but will not be sustainable. The problems will take a long time to work out and even then, profitability will be disappointing. Consolidation will be one way for companies to deal with their contracting environment. Riverplace Capital anticipates that there will be a great deal of consolidation in banking and financial services, home construction, and real estate in general.

The growing sectors will absorb some of the slack. Exports are becoming more and more important. With the cheap U.S. dollar, manufacturing will even make a comeback. (Our goods are very competitive in the world market.) Agriculture is on a roll and high technology, long our strong suit, is placed to do well.

Fixed Income

Short to intermediate rates will stay low for the time being. The Fed has engineered lower rates to help bail out the economy and stressed financial institutions. Longer-term rates are not responding nearly as much to Fed easing. That is because investors do not want to lend at rates that may not cover future inflation rates.

There is a lot more inflation in our economy than is being measured by the U.S. Labor Department's core rate. If that persists then the bond market is likely to have significant problems in the future.

Exotic debt instruments will not completely disappear from use, but you can believe that anyone lending money today wants to know precisely to whom they are lending, under exactly what terms and with an honest assessment as to their credit worthiness. This is straight forward (vanilla) lending and is the order of today. This is the same philosophy RCM has used in buying fixed income instruments.

Talk With Us cont'd

increasingly clear and we are getting insight into what might be some of the winners. This process is normal, it happens periodically, and provides opportunity for the prepared. So if you would like to work with a firm that understands volatility and can use this process to make intelligent decisions, then Talk with Us.

Talk with Us.

Notice

We welcome Wendy O. Hamilton, CFP® to Riverplace Capital Management Inc. Through Wendy, we offer our clients free financial planning. Riverplace Capital believes strongly in the value of planning. It helps document goals and objectives, and provides a benchmark to measure progress. Planning also helps us provide better and more targeted financial service to you. Clients who have worked with Wendy are pleased with the process and more confident as to their future. If you would like to work with Wendy on a financial plan, contact your portfolio manager at (800) 391-1212.

Investment Strategy

Equities

We seek growth and will not stay with companies that can not demonstrate the ability to grow. Therefore, most of our holdings are in the stronger parts of the economy. We have found a few companies that are able to grow, in spite of not being in the most favorable sectors, but these are the exceptions.

Much of the risk has been rung out of stock markets around the world, we are therefore redeploying some of the cash we raised last year (remember, sell high, buy low). As usual, we are being very careful in our selection process.

Fixed Income

RCM continues its cautious approach to fixed income investing by keeping maturities relatively short. Quality is important so we do not invest in exotic instruments.

Wealth Management

RCM has been reasonably pleased with its allocations. International exposures have been far more volatile than we expected, however, they are still showing good growth characteristics. We are unlikely to make any allocation adjustments in the coming quarter. As with our equity allocations, we are redeploying cash raised last year.



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