



PERSPECTIVES

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Progress not perfection; the economy is still a long ways from good, but it is getting better. Investors still have bouts of jitters, as during this past August when a number of economic statistics seemed to indicate a faltering recovery. Fearing a second dip into recession and general fears about September being a historically poor month for the stock market, investors sold.

Once September arrived, the selling had already occurred and surprise of surprises, economic statistics began to point to further economic recovery, not recession. Investors bought back what they had been selling. Obviously some adult supervision is called for here.

This volatility is due to investors' short term investment horizon. They have become traders, not investors. Having been burned before, they are determined not to be so again. So at the first sign of trouble, they sell. Not only are investors over-sensitized to risk, many of them are leaving the stock market altogether. There have been sixteen straight weeks of withdrawals from equity mutual funds.

In markets, fear and greed create extremes. Extremes create opportunity. The reason we can buy world class companies at very favorable valuations is because of pervasive fear. In an economic recovery, the opportunity is in owning those assets that benefit from improving conditions. What is called for is recognition that when one buys cheaply, inevitably good things happen, though patience is required.

The bond market has been the beneficiary of all the fear. Hoping to avoid volatility and ensure safety, more and more investors are buying bonds. Even though interest rates are at historic lows, investors continue to plow in. Fear does not foster good judgment. This will end badly.

Gold is also getting a lot of investor attention. Gold has historically been seen as a safe-haven during times of financial stress. So it may be participating as part of the fear trade. Consequently it may suffer the same fate as bonds once fear dissipates.

Forecast

Economy

Economic progress has slowed after the initial surge off the bottom of the recession. After inventories were rebuilt and the over-reaction on the downside was erased, improvement has become more labored. It is handicapped by individual debt levels that still need to be worked down and high unemployment.

However, the economy is still recovering. Full recovery will simply take more time. No recovery is a smooth upward process. There are periods of acceleration and deceleration. An average growth rate of around 2½ to 3 percent, plus or minus, seems like a reasonable estimate for the next few years. However, it is probably running at a slower rate currently. We do expect improvement to modestly accelerate

once we get past the election cycle this November and move into the holidays. (Remember, fiscal policy remains very stimulative and the Fed is on our side.)

Some sectors that were hit hard like housing and commercial real estate will go through a long period of adjustment. Others that are leveraged to newly growing industries or international commerce are already doing well. It is a mistake to view this economy and this recovery as a homogenous whole. Therefore, it is also a mistake to invest or not invest based upon averages of economic performance. The investing environment requires much more specificity.

Equities

Some more volatility, but the stock market

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Talk With Us

Fear and Greed; those opposites have driven markets from the beginning of time. They are two faces of the same coin and sometimes work in tandem such as having greedy impulses when investors fear being left behind.

Humans are hard wired to recognize patterns. In markets, we are all predisposed to see patterns. If markets have been going up, we expect that to continue, and vice versa. Certain types of news may produce a certain reaction so when it happens again the same thing is expected.

Patterns also reinforce behavior of groups. Individuals see the same patterns and gain confidence in their observations as others do the same. This is the social aspect of all of us; we are keenly aware of others around us. Reinforcement begets reinforcement and others join in. This is precisely what creates trends and occasionally results in extremes; bubbles and crashes.

We have all recently lived through a real estate bubble and resultant financial crash. Both extremes
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Notice

Riverplace Capital offers our clients free financial planning. We believe strongly in the value of planning as it helps document goals and objectives, and provides a benchmark to measure progress. Planning helps us provide better, more targeted financial service to you. If you would like a financial plan, contact your portfolio manager at (800) 391-1212

MAJOR INDICES AS OF 9/30/10

Large Cap Stocks (S&P 500)	2.3%
Dow Jones Industrial Average	3.5%
Mid Cap Stocks (S&P 400)	10.4%
NASDAQ Composite	4.4%
Small Cap Stocks (Russell 2000)	8.1%
MSCI EAFE	-1.2%
Barclays Aggregate Credit Bond Index	11.11%
Inflation	0.9%

(EQUITY INDICES ARE NINE-MONTH RETURNS EXCLUDING DIVIDENDS)



Forecast *(continued)*

is doing better. July was good, August bad and September very good. All in all, investors are beginning to distinguish among opportunities. Certain categories and individual companies are doing very well as others are languishing. This is precisely what we predicted some time ago; the strong get stronger and the weak, weaker.

We also identified several themes that would most likely be a good guide to helping find profitable opportunities. Those themes are participation in faster growing foreign markets, internet services, the mobile internet, clean water, and green energy. So far so good.

Fixed Income

Fear and risk aversion dominated fixed income markets in the third quarter. Every time another economic concern emerges it keeps alive the fear trade. That trade is buying bonds, hoping to avoid risk and assure the safe return of principal. Unfortunately bond prices can be volatile and produce losses, especially if funds are committed for longer periods of time.

Riverplace Capital believes that bond yields are too low; do not provide a fair return for the risks and, consequently, price bonds too expensively. (Remember that bond prices increase as yields decline.) We see bonds as bad investments at this point.

Bond investors can lose money three ways: (1) default, not getting paid back fully - example subprime mortgages; (2) getting back less than you invested as a result of inflation; (3) getting back much less than other alternatives would have provided - opportunity cost.

Talk With Us cont'd

are unsustainable. Bubbles tend to burn themselves out when almost all potential buyers have already bought and no further buying keeps prices elevated. Crashes burn out for just the opposite reasons; most all potential sellers have sold and no further selling suppresses prices.

March of 2009 was a good example of stock market participants bailing out of good long-term assets merely because others were too until finally most of the so inclined had done so. The market reversed because sellers dwindled to a point where bargain hunters, even as few as there were, overwhelmed the sellers. Buying reinforced buying and a new trend was established. Riverplace Capital recognized the extreme behavior in March last year and began buying. This helped our clients recover from this crisis.

Currently, memories are still very fresh and investors are overly cautious. That is largely why stock valuations have not fully recovered and many bargains exist. In fact this response has resulted in the fear trade creating a bubble in bond prices.

The new pattern is rising bond prices resulting in bond market profits well beyond those obtainable from the interest alone. Unfortunately since interest rates can not go below zero, prices must fall once interest rates move higher. This will produce a stampede to get out of bonds and rapidly falling prices resulting in losses. We are positioned for that eventuality and invest accordingly,

Talk with Us.

Investment Strategy

Equities

We remain optimistic for stock market returns this year. The basis of this optimism is rooted in a belief that the economic recovery is durable, corporate earnings have recovered quickly, interest rates are low, and other alternatives are scarce. Too much professionally managed money has been on the sidelines. Once the stock market moves higher, this sidelined money will need to be committed in order not to be left behind. Professional money management is a very competitive business, so poor relative performance has consequences. We see a 30% - 40% chance that a stampede to invest develops if the stock market appears to be leaving many professionals behind - this would be a "melt-up."

The U.S. stock markets are trading at around 12 times next years earning estimates for the S&P 500 stocks. This is not expensive and leaves plenty of room for a higher valuation. The only reason that valuations are so low is lack of confidence in the future and fear borne out of having already endured two stock market crashes over the past decade. We see this sentiment as an opportunity to buy terrific assets cheaply.

That is exactly what we have been doing. Volatility over the past quarter has worked in our favor, periodically allowing for some terrific

buys. Expect us to continue to use opportunities to apply capital and, conversely, occasionally book some profits. (We are not becoming traders, just trying to use what the markets give us.)

Fixed Income

No thanks, we are not buying bonds. Obviously, there are accounts where bond holdings are required and of course we buy for these, but where investment discretion is allowed, we are not. There is no opportunity here, only risk. Investors can buy a whole host of first rate companies that pay dividends at rates that are far better than those obtainable from bonds.

When we do have to buy bonds, we are staying with good credits and only committing for relatively short durations. This helps mitigate risks in this risky arena.

Wealth Management

Riverplace Capital did not make any allocation changes to its asset allocation portfolios. However, we are likely to make some adjustments in the coming quarter. We will further reduce fixed income allocations and alter the emphasis of what categories get our equity dollars.

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