



PERSPECTIVES

OCTOBER 2011

NUMBER 53

Fourth Quarter

Fear everywhere, fear as far as the eye can see; what a quarter this one was for the investor. There were worries for the economy falling back into recession (the proverbial second dip). Worries out of Europe that their financial issues would spill over into the world financial system and cause another liquidity crisis engulfing the entire world. Fears emanating from China that they were slowing; indicating that a driver of world growth was no longer effective. Furthermore, there were concerns or perhaps disappointment in the U.S. political system that it was so divided and broken, that it could no longer be counted upon to help with the current economic malaise or counted upon to respond to any further crisis.

What a mess; the markets corrected, but didn't cave in. Why, because American public companies are in terrific shape. As a whole, they are sitting on record

cash balances, earnings have been great, sales continue to grow modestly, and future business prospects still look good. All one has to do is listen to investor conference calls and read earnings reports.

So what the markets have is a balance between all of the fears coming true and the fact that companies are doing well and are also priced cheaply. It has been easy to see this dichotomy play out as one side or the other becomes the prevailing mood on any given day; crashing precipitously or rallying in a big way, back and forth. However, concerns have outweighed current corporate conditions keeping markets well off their highs.

The experience of the recent financial crisis is still fresh in investors' minds. As a result they tend to be more touchy and reactive to daily events. This is usually a mistake.

Forecast

Economy

Any forecast one comes up with at this point depends upon one's biases. Our biases are positive. Riverplace Capital Management believes that the crisis in Europe is actually helping coalesce a hastily conceived union into a stronger one. It is also strengthening commitment among all parties to protect and advance what started as a grand experiment. Why, because almost every country has benefited by being a part of the Euro-zone. None wants to go back to a collection of individual states with little market power in a world increasingly dominated by big players.

Certainly, Riverplace Capital Management recognizes that even though something may not have a

high probability, occasionally bad things happen and we could be wrong. Therefore our balanced approach, a focus on quality, and internal hedges help us weather the inevitable storms.

Riverplace Capital Management believes that the U.S. economy is probably stronger than it is given credit for. It probably grew at about a 2% rate in the third quarter. This is a modest acceleration over the first half of this year. As for the fourth quarter, we expect a 2½% to 3% growth rate. These rates are based upon recent corporate results and their improving expectations. This growth rate is not stellar, but will make the over-reaction to fears of a slowing economy look silly.

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Talk With Us

Why does Europe matter? Until recently, the answer was that it didn't. Now daily investment commentary is replete with news about Europe. Why it now matters boils down to two major concerns. The first is growth. Our own growth in the U.S. has been so weak that the belief is that weakness elsewhere will affect us here. It is a case of interconnectedness. To a degree, that is the case, however, it is blown all out of proportion.

There have been many instances when Europe or the U.S. has been in recession and the other was not. The belief in contagion assumes more interconnections than actually exists. Although many American products are sold in the EU, most are made there. So the affect would be more on the earnings of some of our multinational firms, but might not affect our economy much.

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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 9/30/2011

Large Cap Stocks (S&P 500)	-10.0%
Dow Jones Industrial Average	-5.7%
Mid Cap Stocks (S&P 400)	-13.9%
NASDAQ Composite	-9.0%
Small Cap Stocks (Russell 2000)	-17.8%
MSCI EAFE	-17.2%
Barclay Aggregated Credit Index	6.9%
Inflation	2.0%

(EQUITY INDICES ARE NINE-MONTH RETURNS EXCLUDING DIVIDENDS)



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Forecast *(continued)*

Equities

Equities continue to be undervalued compared to historic averages and comparisons to other asset classes. In fact some of the best buys we have ever made have been under conditions of fear in the stock market. We have plenty of that right now. Therefore, Riverplace Capital Management predicts much higher valuations and stock prices in time. In fact, we still expect a positive return this year and it may even be better than that.

Even though we expect improved financial conditions in Europe, we can not be precise about the timing. We also do not expect all of the various concerns outlined in the first section of this letter to be resolved. Some may linger for some time and even resolution might be considerably less than absolute – that's life; more messy than simplistic. However, that is nothing new. Markets move based upon balances, more good than bad or the opposite. There is an old saying that bull markets advance up a wall of worry.

Fixed Income

Fear has driven interest rates down to ridiculous levels as more and more money seeks the safety of this asset class. Riverplace Capital Management sees little value here and lots of risk, just the opposite of common perceptions. However since the Federal Reserve has committed to keeping rates low until the middle of 2013, we see this condition persisting. As a result, we have created income portfolios of high dividend paying stocks. Not only do clients make more current income than is currently available in most bonds, they do so with potential for future dividend increases and capital appreciation.

Talk With Us cont'd

The second major concern is financial contagion. If there was a default by one of the sovereign countries on their debt, it would create major problems for banks throughout Europe. These banks hold most of this debt. Some of these banks might actually become insolvent, because they have not adequately set aside reserves for this possibility.

Not knowing which banks were healthy and which were not, there would be a replay of the recent financial crisis in the U.S. One bank would not want to lend to another in case they might not be paid back. The system would freeze up. The system would also include many U.S. banks. This liquidity crisis could push both Europe and the U.S. back into recession. There could be a number of variations to how a liquidity crisis could get started, but they all have a negative impact.

For this reason Europe matters. Most recently the EU has taken steps to put in place a much more adequate facility to provide liquidity and help handle any default. More importantly it can be used to head-off such a possibility. This particular risk has not been eliminated, but it has certainly been substantially reduced. Riverplace Capital Management believes that such a scenario will be averted. One should not discount the intelligence and current efforts of the European authorities. So if you want to understand those factors that affect your portfolio,

Talk with Us.

Investment Strategy

Equities

With the terrific buys we see throughout the equity market, it has been hard for us to be very negative. The outlook from the pundits, economists, and market players talking up their own book just didn't jive with the results and outlook coming from companies on the front lines of the economy. Riverplace Capital Management has always recognized that information coming directly from businesses themselves is the most reliable.

As a result, we have held our positions and to our strategy. We continue to believe that the economy is in extended recovery. Therefore, business conditions will continue to slowly improve. As a result, corporate profits are not at peak levels, but will continue to grow. This is a prescription for higher stock prices; in our estimation – much higher prices.

Fixed Income

We are only buying bonds for a few particular circumstances. Where income is needed, we are substituting high dividend paying stocks. This gives the owner the possibility of higher dividends over time as well as the potential for stock price appreciation. Obviously there is some volatility to owning such a portfolio, but it is much less than the market at large.

Wealth Management

We have a growth bias in our asset allocation accounts. As a result, these accounts have suffered from the recent volatility, but are properly placed if our outlook proves out. We do not foresee making any changes before year-end.

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