RIVERPLACE
· CAPITAL ·
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Perspectives

April 2014 Number 63

FIRST QUARTER SUMMARY

Up, down, round and round; the stock market has gone nowhere fast. Corrections come in two types; amplitude (price change) or time.

We have been going through a correction of time. Last year was such a strong year for returns that it may make sense for investors to take stock for a period of time.

Another reason for a pause is that an extremely rough winter across much of the northern part of the country has made it difficult to determine the health of the economy. Economic statistics over the first quarter have to be tentative. If weather was as big a factor as we have surmised then the economy ought to snap back this Spring. We will be watching closely.

The stock market really held up well considering how many potential negatives have been thrown at it; an emerging market crisis, troubles in the Ukraine and Crimea, economic uncertainty in the U.S., and new leadership at the Federal Reserve. The market may have looked to be on the ropes at times, but always came back swinging. The next few months ought to really show what this market is made of. (See what we think in our *Forecast* section.) ◆

> "How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case."
>
> — *Robert G. Allen*

TALK WITH US

Many prospective clients are curious about our research and investment process. It is not enough to simply say, "Look at our record". Over time we have added value by exceeding benchmarks. They want to know that we have a process that enables us to continue this record. So in short, here is how our process works.

We use a matrix of analysis. The matrix has four elements; a top down review of where in the business world we see opportunities for growth, then a bottom up in depth analysis of any prospect as to its quantitative metrics, and qualitative qualifications.

Top down is an informed view of the business environment, not just in the U.S., but in other parts of the world too. We have data from various countries, regions, and industry sectors. Our decisions are not purely data dependent, because data is by its nature hindsight, but it does help us make assessments about turning points and future trends. This is not a mechanistic process, but one that is one honed by experience.

The bottom up approach focuses on the individual investments themselves. In many cases we search for businesses that participate in an area where we see opportunity. It could be a relatively new business or service, perhaps one consolidating a sector, one splitting up a company with several non-related endeavors thereby releasing value, or any other number of value creations. Sometimes it is as simple as operating a great business well and continuing to produce value every year.

After we have identified particular candidates, we put them through a quantitative screening process. Here the prospect has to meet or exceed a number of financial metrics or hurdles. These are the typical metrics that most investors would be interested in such as profitability, financial strength, past and future estimates of growth rates for revenues, cash flow as well as profitability and some other indicators meaningful to us.

The last analysis is more qualitative. It is mostly subjective, but informed by decades of experience in selecting successful investments. Here we try to get a sense of management, the company's commitment to its shareholders, lack of internal drama, perhaps signifying and well-formed and smooth functioning management team, just to name a few. We've seen thousands of companies and know many of the factors that make ones exceptional or merely also runs.

In our analysis, we never expect everything to be perfect, but there are some deal breakers. Only a few make it through our process. This is why we believe we can continue to add value for our investors. So if this high level of investing discipline appeals to you, then **Talk with Us**. ◆

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FORECAST

ECONOMY

The first quarter GDP growth rate is likely to be suppressed by the terrible winter weather. This should be no surprise to investors so we do not expect much of a reaction to the obvious. Of more interest will be how the spring quarter shapes up. We have every reason to believe that there will be a significant snap-back in economic growth. In fact fundamentals throughout the winter months were stronger than many investors expected.

For the rest of the year, we are forecasting continued acceleration. The economy has been growing at about 1½% to 2% for the last several years. We now expect the pace to approach 3%. The reasons are that several industries such as construction and manufacturing have recovered and are now growing again. New sectors in healthcare, pharmaceuticals, and energy production are adding many new jobs. All is not perfect, but we have come a long way from the lows of the 2008 financial crisis.

EQUITIES

We believe that the recent correction of time will lead to higher stock prices. The fact that the market absorbed many negatives during the first quarter and remained near record highs bodes well for the market's inherent strength. Earnings and dividends continue to grow, while interest rates remain low offering little alternative. Valuations are no longer cheap, but are fair. Markets should be able to advance in line with the growth in earnings and better economic prospects.

The financial crisis that began in the United States starting in 2007, then later moved to Europe, and finally affected emerging markets is ending. The U.S. has recovered, Europe has begun to recover, and emerging markets are bottoming. If emerging markets begin to recover soon, all major investing regions will be moving higher together. That usually is an ideal situation for increasing stock markets.

FIXED INCOME

Last year, bonds as measured by several intermediate and long-term bond indices, had negative returns. RCM has been warning for some time now that bonds, especially ones with longer-term maturities, posed substantial risks. We still believe they do.

Even though interest rates did advance last year, they are far from what we would consider normal for our economy. The pace, at which interest rates advance from here, is unknown, but they most assuredly will. We will remain cautious on this investment category. More losses are probable.

INVESTMENT STRATEGY

EQUITIES

Higher prices are what we expect. The timing is uncertain. We essentially have been going sideways for a quarter now. However, fundamentals continue to improve, earnings are increasing and a broadening economic recovery adds resilience.

We continue to review our holdings to reassure ourselves that their prospects are good and they continue to present good values. This is both a subjective as well as objective process. It follows on our initial process for selecting new investments. That process is reviewed in the Talk With Us, section of this letter.

Since we believe that higher earnings will be led by an improving economy, it stands to reason that those companies that most benefit from economic expansion are emphasized.

Those include companies in the materials, industrial, technology, energy and financial sectors.

FIXED INCOME

For those accounts that need them, we are finding a few bonds that are suitable. We don't expect much return from these, but the returns are better than cash. Of course, we are keeping the maturities in the holdings relatively short. Our preference is to own higher dividend paying stocks however, if appropriate.

As interest rates rise, we should be able to find more bonds to buy. For those clients that need to have bonds in their accounts, thank you for being patient as we avoided making bad investments at historically low yields. We will continue to use caution.

WEALTH MANAGEMENT

Early this year we rebalanced our asset allocation accounts. We reduced our overweight in small-cap stocks and added back mid-caps. Small-caps were getting too expensive. We completely eliminated emerging market weightings, but did add to foreign developed markets, especially Europe.

No further changes are expected until we see sustained performance from emerging markets. So far, that performance has been negative. We just do not know how much longer that will take. We are happy with the current allocations.

MAJOR INDICIES

as of 03/31/2014

Large Cap Stocks (S&P 500)	1.3%
Dow Jones Industrial Average	-0.7%
Mid Cap Stocks (S&P 400)	0.8%
NASDAQ Composite	0.5%
Small Cap Stocks (Russell 2000)	0.8%
MSCI EAFE	0.0%
Barclay Aggregated Credit Index	3.04%
Inflation	1.1%

Equity indices are twelve-month returns excluding dividends

NOTICES

Check out our new web site. It offers a lot more information for you including a blog with recent updates. We look forward to your feedback. www.riverplacecapital.com

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.

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