



Riverfront Investment Group, LLC  
9011 Arboretum Parkway, Ste. 110  
Richmond, VA 23236

TEL 804.549.4800  
FAX 804.549.4819  
TOLL FREE 866.583.0744  
www.riverfrontig.com

**Trader Notes: April 9, 2008**

**Doug Sandler, CFA**

### **Beware of Managed Care and Retail; Software Remains our Preference over Hardware.**

**Managed Care:** More often than not the market will signal something is wrong before the fundamentals reflect it. We find listening to the market particularly useful in industries where a single news event can have significant and lasting implications. Companies who are reliant on congressional or agency approvals like the FDA or price setting authorities like state utility boards are most vulnerable to one bad news announcement. Therefore, when we see one of these at-risk companies or sectors sending a disturbing technical signal, our antenna perks up. One such industry that is beginning to show up on our radar is healthcare services, specifically managed care. Managed care companies have steadily outperformed the market since 2000, but recently have reversed that trend. Last month several managed care companies were punished severely (down 20+%) after warning of pricing missteps and a costly flu season. Normally, after such a significant news-related drop, one would expect the previous positive trend to re-establish itself. A strong bounce would be even more likely if the news is expected to be temporary or one-time in nature, as many analysts and company spokespeople classified the event. However, in the 30-days after the sell-off, no bounce has occurred and the managed care group has continued to underperform the S&P 500. In our opinion, this is a very bad sign. Managed care companies are likely to face pressure from two-fronts in 2008 and beyond. First, we are in an election year and these companies have historically been a favorite target for vote-trolling politicians. Second, a weakening U.S. economy will make it more difficult for these companies to pass along cost increases to their members. From our perspective we chose not to wait around to see how the story ends, we have sold all of our direct managed care exposure from our portfolios in the past 4 weeks.

**Retail:** This week's *Equity View* notes retailers' vulnerability in the upcoming earnings season. We think the main risks are lower margins, as retailers are forced to slash prices to draw customers, and higher costs. This morning's *Wall Street Journal* (April 9, 2008; C1) confirms the pressure retailers are facing and reports that other prominent retailers like Linens 'n Things may be forced into bankruptcy, similar to Sharper Image. We believe the greatest risks in the retail sector occur among the large, non-specialized retailers, like the department stores, casual-dining restaurants and Retail REITs. Remember, in the last consumer-led recession; retailers did not just get hurt. They went out of business. We continue to believe the market is taking a potential consumer-led recession too lightly and recommend a continued underweight in the sector.

**Technology:** In the technology sector we continue to favor software companies over hardware companies. The earnings from software companies have historically been more resilient to economic conditions and more predictable, as was underscored in Advanced Micro Devices (AMD-N-\$6.03) earnings miss yesterday. Technology represents roughly 16% of the S&P 500 and software makes up just over 20% of technology (or 3.5% of the S&P 500). We recommend an overweight to software in portfolios and favor companies and ETFs like: iShares Goldman Sachs Software ETF (IGV-A-\$46.23), Microsoft (MSFT-O-\$28.75), Electronic Arts (ERTS-O-\$52.44) and Citrix (CTXS-O-\$33.14).

*The specific securities identified do not represent all of the securities purchased, sold or recommended for client portfolios. Riverfront Investment Group client portfolios currently own shares of IGV, MSFT, ERTS and CTXS. Other securities mentioned may be considered by Riverfront Investment Group for purchase or sale in client portfolios in the future. The opinions expressed are current as of the date shown and are subject to change. They are not intended to be investment recommendations. Past performance is no guarantee of future results.*