

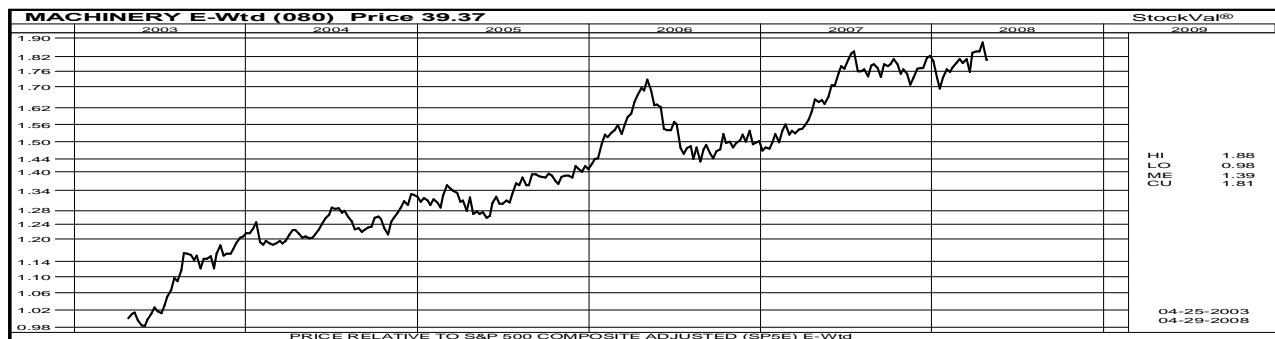
April 30, 2008

### Forecasts of a Bottom in the Dollar Kills Commodity Sensitive Stocks

The last week has been painful for investors in commodity sensitive stocks like machinery, metals & mining, and oil and gas. A growing consensus believes that after today the Fed will be done cutting rates, the U.S. Dollar will bottom, and the reflation-plays will stop outperforming. We have never claimed to be "Fed Watchers" and thus do not dispute the market's forecast on the current tenor of the Fed, however, we are not yet ready to recommend reallocating portfolios on this belief for the following reasons:

1. Over the last year, the market's aggregate opinion of what the Fed should do has been extremely fickle. Today, the market wants the Fed to stop. It wasn't long ago that the market claimed the Fed wasn't moving fast enough. Opinions can change quickly and the "new Fed" has appeared sensitive to market polls.
2. Commodity sensitive companies have been driven by more than just a falling dollar. We believe we are in a secular period of supply/demand imbalances. Yes, the falling dollar has led to some excessive speculation in the commodity sensitive stocks, but recent activity has driven many of the speculators out of these companies. Ultimately, these stocks will be driven by earnings growth and thus far we have seen little to discourage us.
3. "V" tops are rare. The three charts below show the relative performance of the machinery, metals and mining and oil & gas groups relative to the equally weighted S&P 500. The common characteristic among the three groups is they have all recently made new relative highs vs. the market. There are times when drastic shifts occur in the market and groups go from relative strength winners to relative strength losers in a blink of an eye, but those occasions are rare. Normally, a topping pattern takes time and is tested on multiple occasions. This may ultimately prove to be the top, but in our opinion, it is far too early to make that forecast. Instead, the recent activity feels more like a counter-trend sell-off where the sickening drops shake out the "weak hands" before the groups begin another leg up.

**Bottom Line:** One of the greatest mistakes investors make is selling their winners too early and holding on to their losers too long. Sectors in strong secular up-trends often go through quick and significant down-moves to test an investor's fortitude and encourage them to take their profits off the table too early. We think a better strategy is to give strong groups a longer leash and greater latitude and focus risk management energies on the serial underperformers instead. Therefore, the last week of weakness and the predictions by many about the Fed and the dollar is not yet enough to shake our conviction in these sectors. Importantly, our continued bullishness on machinery, metals and energy stocks is not dependent on rising commodity prices. We fully recognize that commodity prices are extended and the long-term upside is questionable (see our *Weekly View* and *Strategic View* publications), however most of the companies operating in these industries have discounted current commodity prices and we believe could tolerate a fall in commodity prices without a commensurate drop in earnings estimates.





All Charts Courtesy StockVal

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