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Our Favorite Satellites: Part 3

The core-satellite approach to portfolio management allows investors to better identify, quantify and adjust the amount of risk present in a portfolio. Implementing the approach is relatively simple and can be done from a sector perspective. To start, and investor would begin with a core position in each of the 10 S&P sectors. The size of the core position depends on the oneÕs level of conviction around their satellite bets. A rule of thumb is that the core should be at least 50% of the total sector exposure and can run as high as 100%, in cases where an investor cannot find or has little conviction around suitable satellites. The size of the satellite is also a function of an investorÕs conviction level, but should at least be larger than the percentage shown in the ÒS&P 500 Industry WeightÓ column. The core or satellite positions can be a broad sector ETF or specific securities.

Also, be sure to look at our monthly *Portfolio Navigator* publication that regularly encapsulates our thinking on the core/satellite approach: http://www.riverfrontig.com/pdfs/equity/Gameplan%20for%20April%2008.pdf

Today, we focus on the three remaining S&P sectorsÉ Next week we will conclude this series with our outlook on Information Technology, Telecomm Services and Utilities.

- Materials, Cons. Discretionary, Staples and Energy, Check out Part 1: http://www.riverfrontig.com/commentaries/documents/tn052108.pdf
- Financials, Healthcare and Industrials, see Part 2: http://www.riverfrontig.com/commentaries/documents/tn052208.pdf

Sector	Core	S&P 500 Sector Weight	Industry Satellite	S&P 500 Industry Weight	Rationale
Tech	Vanguard Technolgy (VGT-A-$56.86)	16%	iShares Goldman Software (IGV-A-$50.62)	3.5%	Technology over time has proven to be a poor investment. While there are significant opportunities for short-term investors and traders, few tech stocks have proven to be attractive investments over the long-haul. We think the main reason for the long-term lackluster performance boils down to two things: 1. The pace of innovation is so rapid, few companies can stay in the lead for longÉ and 2. Investors pay too much for them. Paying a high price for a group of companies that may not have a long-term sustainable competitive advantage is a recipe for disappointment and a lesson that many investors have had to learn the hard way. Within technology, some industries are better than others. Technology hardware, which includes PCÕs, networking gear, and semiconductors; have been the most disappointing because the Òleader boardÓ is always changing. Therefore, it is segment of technology that we are nearly always ÒUnderweightÓ. On the other hand, software, services and data processing have historically been able to maintain their competitive advantage for longer periods of time. The main issue with this group is to closely watch valuation. ÒHotÓ new software applications like Linux, or Network Security, always trade too richly when the ÒbuzzÓ is high, however they become far more attractive investments after the hype subsides. Unfortunately, there are no direct ETF plays on services or data processing; however it is possible for an investor to overweight software.
Utility	Vanguard Utility (VPU-N-$85.22)	3.6%	Claymore Global Water (CGW-A-$25.23)	0%	With the threat of Recession looming, interest rates should stay low keeping a floor on utility stocks. We currently recommend at least a Òmarket weightÓ to the group and would be comfortable with a Òslight overweightÓ.
Telco	Verizon (VZ-N-$37.38)	3.4%	N/A	N/A	The large telco service companies should trade similarly to the utility sector. Both groups offer slow and steady growth, with lower economic cyclicality. Since telecommunication stocks have a little less protection (rates are not regulated, and competition is higher), they should trade at a slight discount to utilities during bear markets and at a premium during bull markets. Today, telco trades at a 2 multiple point discount to the utility group, which we believe is reasonable and unlikely to expand or contract in the near-term. Within Telco, we favor the large integrated service companies over their pure-play wireless peers.

Statistics Courtesy Factset

Doug Sandler, Chief Equity Officer • 804-549-4803 • dsandler@riverfrontig.com Åwww.riverfrontig.com
Riverfront Investment Group, 9011 Arboretum Parkway, Suite 110, Richmond, VA 23236