The *Prudent-Growth* Portfolio

April 2013 - Week 2

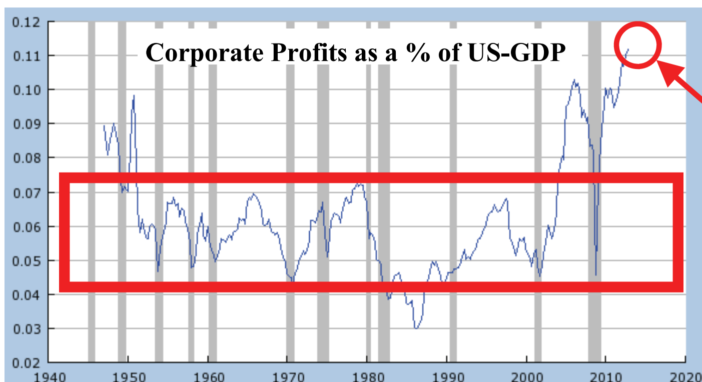
INDICATIONS OF HIGH-RISK MARKET & WEAKENING MACRO. RAM TAKING PRECAUTIONS.

The Investment Climate:

Macroeconomic indications suggest that the weakness that began in March is continuing into April. Given the relatively high degree of investor bullishness (a negative for the stock market), the extent of the market's 4-year recovery, and the topping formations for some major stocks (IBM, McDonalds, GE & money-center banks), we believe it is prudent to reduce our exposure to stocks at current valuations.

While stocks are not at extreme relative and absolute levels, the earnings upon which these valuations are predicated may not be sustainable in spite of the Fed's accommodative nature. In addition to the so-to-be-felt impact from the sequester, which should reduce consumer spending and thus corporate revenues and profits, the overall level of corporate profits appears unsustainable, assuming history is any indication.

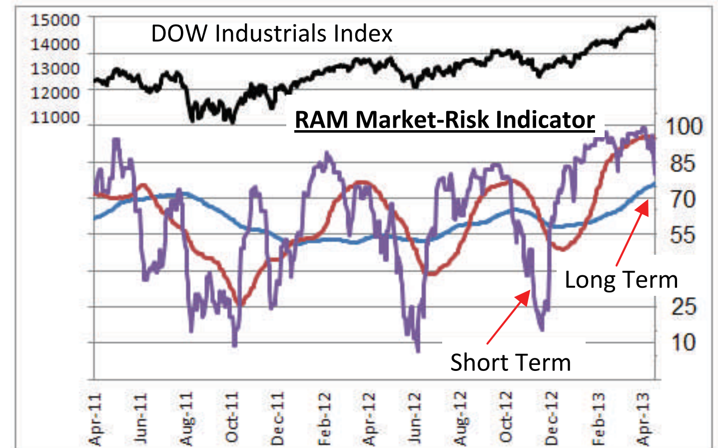
Since the late 1940's corporate profits as a percentage of the US GDP, from which they are derived, have ranged between 4% and 7%. But during the past two bull markets since 2003 corporations have enjoyed almost double the previous 50-year's mid-point and are currently at an all-time high level of 11% (see chart). This puts the traditional and simple P/E methodology for stock-valuations at risk that the multiple is being applied to earnings that are not sustainable. Thus what looks like a fairly priced stock market may be extremely overvalued.



While we have some issues with the corporate-profits-to-US-GDP yardstick, because it does not account for the penetration of international GDP by US corporations, we do believe that corporate profits have enjoyed the unrepeatable benefits of low interest rates, tax exemptions, and under-spending on capital investment that, when normalize, reduce profits considerably.

We are seeing evidence that the economic weakness in March is showing up as first-quarter earnings-reporting season gets underway here in April. Major companies, especially those with European exposure, are reporting modest year-over-year earnings growth and unimpressive revenue, and forecasting more of the same for the balance of the year.

In addition to all of the above, the struggles with finding sources to fund US deficits, that are forecasted to stretch out into the distant future, may put corporate profits as an easy and significant target for Washington. We have witnessed several politicians proposing bills that include corporations as a source for additional taxation.



The Portfolio Strategy:

We have been steadily reducing exposure to stocks during this rally as Europe has struggled to shake off the post-2008 financial crisis. But with the March data for the US implying a heightened risk of recession, especially if the slowing of growth in China picks up stream, we have also moved toward more defensive names within RAM's prudent growth universe of companies. To this end we moved out of some consumer-discretionary stocks such as Ann Taylor, Gap Stores, and industrial stocks Emerson Electric and Boeing, the latter especially now that a remedy for the lithium battery issue is in the price of the stock, and energy stock Schlumberger.

While we remain leery at these levels we do not feel this is like the 2007 top when we virtually eliminated all stocks in the portfolio. We must acknowledge that we are 13 years removed from the 2000 top when the market traded at same levels but now generates greater earnings. Thus, while strategizing toward the conservative, we have replenished some of this portfolio space. Examples are, Coca-Cola, which should benefit from the expected continuing suppression of interest rates in spite of its good stock-price performance to date, and Ben Franklin (BEN) which should continue to enjoy baby-boomer retirement deposits.

Typically, if the market is to top out soon and break to the downside, investors who have missed much of the rally since 2009 will provide new sources of cash to generate a rewarding rally. We expect to take advantage of this rally while also measuring it to see if the bull market will continue to higher levels (probably thanks to the Fed's continued efforts to get unemployment rates down to the 7% target) or that it is the first of many rallies but in a new long-term bear market. We do not have to determine that outlook at this time instead opting to become more conservative with our exposure and more defensive in our stock selection.

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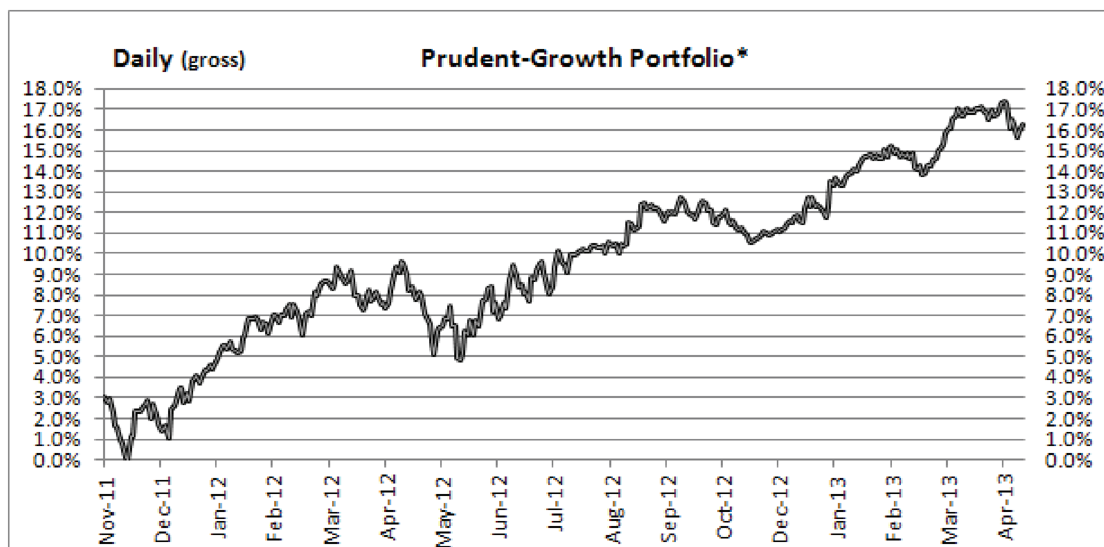
*RAM taxable SMA account. *see disclosure for details.*



* DISCLOSURE

Past performance is not indicative of future results.

The performance shown in all charts for RAM's Prudent Growth Portfolio is for a single-managed account (SMA) managed on a fully-discretionary basis by RAM Capital Management LLC (RCM) and that adheres fully to RCM's Prudent-Growth investment process and portfolio execution. In some cases, due to the modest size of an account or if client restrictions are placed on the account, the SMA account's performance may vary.

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The past performance for January 1, 1996 to September 30, 2010 is for the RAM Capital L.P fund. The prior performance is net of transaction expenses and net of management fees (0.50% per annum). Also prior performance does not include the effect of the LP's performance fee, which does not apply to SMA's. On October 1, 2010 the partnership was converted to, and its performance ported to, the RAM Risk-Managed Growth Fund, a mutual fund adhering to the Investment Companies Act of 1940 and regulated by the SEC. Past performance since the conversion is net of management fees (1%) and expenses (0.25%), terms incorporated in the fund's prospectus. The latter expense does not apply to SMA's although all commissions and other charges, fees and expenses associated with an SMA are the responsibility of the SMA owner. The LP and the mutual fund were managed in the same style and by the same portfolio manager and advisor, RAM Capital Management LLC, since the fund's inception on January 1, 1996. Effective September 30, 2011 all performance for the Prudent-Growth portfolio is based on a representative SMA and are net of expenses and net of management fees (0.50% per annum) except in daily-performance presentations. **The past performance is not necessarily an indication of how an SMA will perform in the future.**

The S&P 500 Index is an unmanaged composite of 500 large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. You cannot invest directly in an index.

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