# The *Prudent-Growth* Portfolio

October 2012 - Week 1

## LOOK FOR ESM RESCUE OF SPANISH BANKS TO PROP STOCKS. WE CONTINUE TO PRUNE.

### *The Investment Climate:*

Weak durable goods, downward revisions to the GDP, and softness in China continue to point to approaching economic weakness. Look for earnings reports to be ok with 22% contribution from the bank sector that can report what it wants short term.

But at the end of this week the European Stabilization Mechanism (ESM), the European bank rescue fund which will replace the temporary emergency funds EFSF & EFSM, becomes operational and by mid-October the EU is expected to direct funds from the ESM to enable the recapitalization of Spanish banks. The concept is the good bank/bad bank. The bad real-estate loans get placed in the bad bank allowing the now independent good-bank to get back to the business of lending which leads to economic stimulation. At least that's the theory. As a result the needle for recovery should continue to move in the right direction. But the markets have already recovered. In the end the creation of the ESM has effectively rendered toothless that part of the Lisbon Treaty under which Germany hoped to exercise austerity measures upon countries that still have long-term sovereign debt issues.

While we welcome action on the bank balance-sheet issues we believe the creation of the ESM and the unilateral powers that it comes with allows the EU to, like US politicians, kick the can down the road. In this case the "can" remains the ongoing imbalance of government spending versus government tax revenues. The enactment of short-term solutions (the ESM) without offsetting long-term solutions implies long-term issues for major stock markets especially given the extent of the rallies of the past four years.

While many pundits have become enamored by the US stock market as an investment haven remote from the problems of Europe, the fact remains that, at these levels, the US stock market will suffer from contagion in the likely event of European stock market declines when the long-term consequences of not exercising austerity becomes discounted in stock prices.

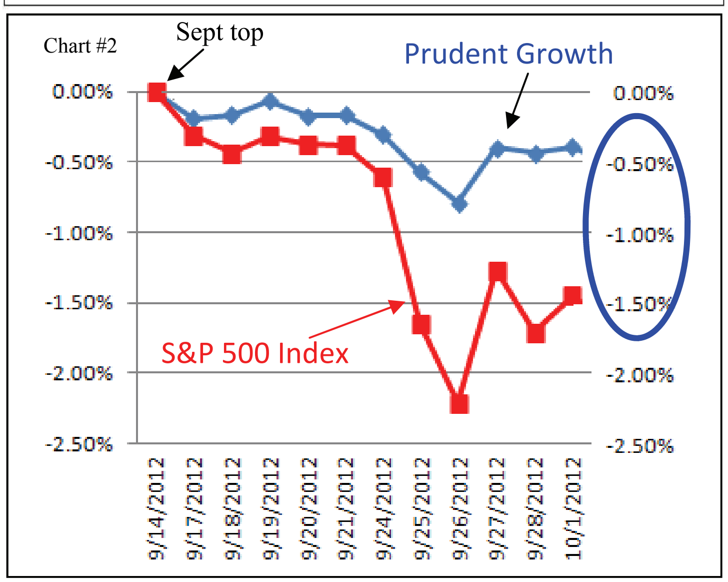
In the short-term we expect investors to react positively following the Oct 18th meeting of the EU at which it is expected to authorized the ESM to deploy the funds.

Chart #1 shows the upward-trending channel within which the market is trading. The red line represents the point of resistance for the market and the green line the point of support. Currently the market resides in the lower region of this channel offering an attractive short-term risk/reward ratio of 3% upside versus 1% downside, all else equal.

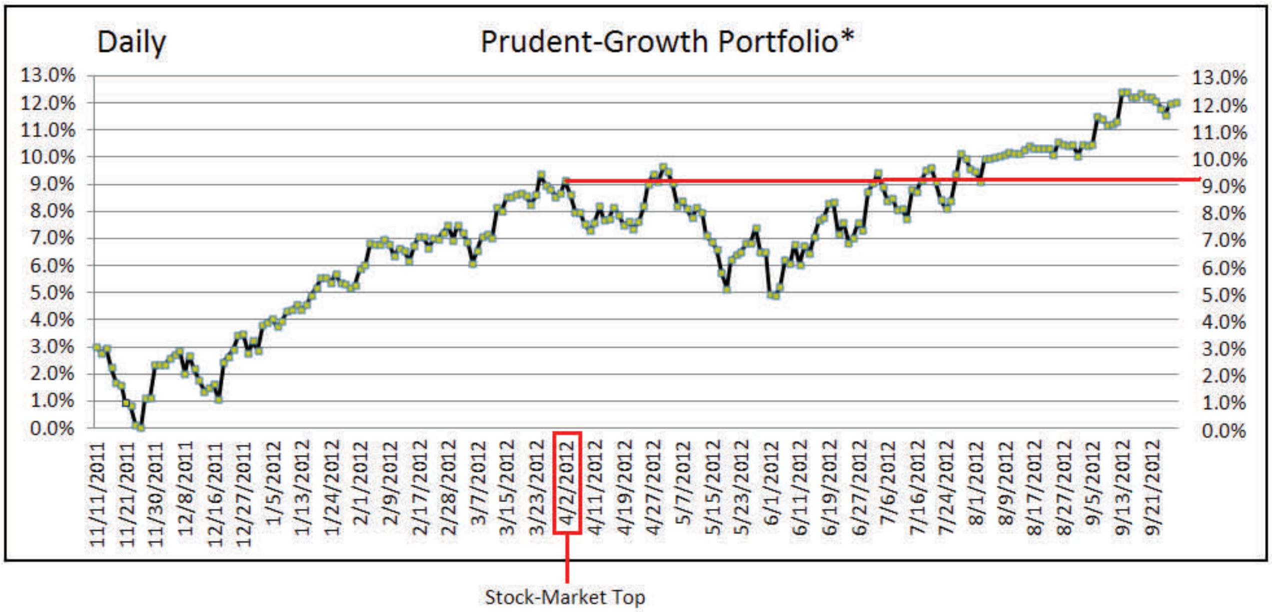
### *The Portfolio Strategy:*

Chart #1 also points to the "prudent" aspect of the Prudent Growth (P-G) style. Note that since the April 2nd market top both the P-G style and the market have recovered to new highs. But also note that P-G suffered only 40% of the market's 10% decline and without giving up the gains now enjoyed at these new highs. In fact, P-G has generated greater returns, although this outperformance would probably be ceded upon a spike to higher-highs given the pruning strategy we have implemented of late.

Over the past two weeks we have reduced our holdings by another 6 stocks to 22. As always our guide to choosing the candidates for sale remains the *ROI Stock-Selection Model.* Given the issues discussed in the "climate" section of this report we expect to continue to sell into any rally from these levels. Recall that at the Nov'08 market-lows we raised the number of equity positions in the P-G Portfolio to 88 from the 7 held at the market-peak in 2007. Now at 22 positions we believe the "prudent" aspect of our discipline (see chart #2) will put us in a position to be opportunistic if investors react negatively to the plethora of dark clouds on the horizon whether they be the election, the fiscal cliff, the economy, the budget deficit, or the unpredictable.

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




## * DISCLOSURE

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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 management fees (1% per annum), and net of other expenses. 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 it's performance ported to, a mutual fund adhering to the Investment Companies Act of 1940 and regulated by the SEC. Past performance since the conversion are net of management fees (1%) and expenses (0.25%). The latter does not apply to SMA's although all commission and other charges, fees and expenses 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. **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.