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Our Favorite Satellites: Part 1

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, an investor would begin with a core position in each of the 10 S&P sectors. The size of the core position depends on the investor's 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 investor's conviction level, but should at least be larger than the percentage shown in the S&P 500 Industry Weight 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 4 of the S&P sectors. In the coming days we plan to focus on the remainder:

Sector	Core	S&P 500 Sector Weight	Industry Satellite	S&P 500 Industry Weight	Rationale
Basic Materials	Vanguard Materials (VAW-A-\$97.31)	3.6%	SPDR Metal & Mining (XME-A-\$89.42)	1.2%	Our satellite approach in materials boils down to: Underweight Chemicals. Chemicals are nearly twice as big as any other industry within the materials group. Due to the energy intensity of producing chemicals and the more aggressive competitive environment, we believe chemicals are destined to underperform over time and would underweight them by owning a satellite position in non-chemical industries like metals and mining.
Consumer Discretionary	Vanguard Consumer Disc. (VCR-A-\$52.11)	8.6%	Powershares Media (PBS-O-\$13.99)	3%	Successfully navigating the discretionary group during a consumer-led recession will be difficult, and the winning strategy will likely be the one that loses less. Our M.O. in the group is to avoid those areas that either represent the most discretionary purchases by the consumer (autos, restaurants, hotels), or are the least differentiated (multi-line retail, apparel). Once those industries and companies are eliminated, there are few opportunities remaining in the group. One area that has some promise is media. Media stocks have been in a bear market since the bubble burst, and catalysts like the Olympics and the presidential election are on the near-term horizon.
Consumer Staples	Vanguard Consumer Staple (VDC-A-\$69.31)	10.4%	Colgate-Palmolive (CL-N-\$71.78); Church & Dwight (CHD-N-\$57.23)	2.5%	We like the Staple group due to its historically defensive characteristics, but it is tough to get excited about its lackluster single-digit earnings growth prospects. However, the household product and personal care industries are one of the few bright spots and are still displaying 12-14% EPS growth and are surprisingly valued less expensively than their slower growth peers. Unfortunately, there are no personal care/household products ETFs so an investor must purchase an individual stock.
Energy	Vanguard Energy (VDE-A-\$130.52)	14%	SPDR Drilling & Service (XES-O-\$49.70)	3%	While we like most industries and companies in the energy patch, we believe the drilling and service companies represent the most attractive values. These stocks have lagged in recent months as investors gravitated to the more pure-play E&Ps to benefit from the rising price of energy commodities. However, ultimately we believe the drilling and service sector will play catch-up and investors overweighting this industry should see outsized returns.

Statistics Courtesy Factset

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