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Our Favorite Satellites: Part 2

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 óS&P 500 Industry Weightô 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 3 more of the S&P sectorsé Next week we will conclude this series with our outlook on Information Technology, Telecomm Services and Utilities.

To see our view on Basic Materials, Consumer Discretionary, Consumer Staples and Energy, Check out Part 1:
http://www.riverfrontig.com/commentaries/documents/tn052108.pdf

Sector	Core	S&P 500 Sector Weight	Industry Satellite	S&P 500 Industry Weight	Rationale
Financials	Vanguard Financial (VFH-A-$46.00)	17%	Powershares Banking (PJB-A-$19.33), US Bank (USB-N-$32.94)	4.8%	Truth be told, there is not a lot to like in the Financial Sector. The credit bubble was the ófirst shoeô to drop and a likely U.S. economic recession may ultimately serve as the ósecond shoeö. Our satellite approach in financials is to favor the industry with the greatest transparency, the most reasonable valuation, and the greatest beneficiary of Fed lending. We think the banking sector fits this description best, particularly the more traditional banks focused on the mid-section of the U.S. We would continue to avoid the large diversified, ófinancial-supermarketô banks due to the inherent difficulty of gauging their exposures, as well as capital markets companies and REITs.
Healthcare	Rydex Equally-Weighted Healthcare (RYH-A-$52.61)	11.3%	iShares Medical Devices (IHI-A-$57.44)	2%	The óeasyô bet in Healthcare has been to underweight the pharmaceutical companies and overweight everything else. Believe it or not, the big pharmas still account for over half of the S&P Healthcare sector. While this figure is down from the 75-80% representation this group had in the 90õs, we still believe it has further to fall. Medical device companies, on the other hand, represent less than 20% of the healthcare group and do not have the patent expiration issues or the reputational issues that have plagued the drugs. Therefore, we continue to recommend a secular overweight to devices.
Industrials	Vanguard Industrial (VIS-A-$71.51)	11.8%	iShares Aerospace Defense (ITA-A-$63.68)	3%	As the U.S. flirts with recession, we continue to have difficulty believing that our woes will not spread beyond our borders. The Industrial sector has benefitted from the globeõs relative immunity to our economic problems thus far, and the majority of Industrial stocks no longer incorporate a órecession-discountö. We believe that as fears of recession return to the market, the shares of industrial stocks are vulnerable to additional mark-downs. Defense companies, on the other hand, have historically been less sensitive to broad economic conditions and run on their own unique cycle that is not necessarily correlated to the U.S. economy. With global tensions high and escalating oil prices likely to continue to fuel unrest, we anticipate few cutbacks on defense spending and believe the spending cycle will last longer than the market expects.

Statistics Courtesy Factset

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