



The Rainier philosophy is simple. We invest in quality growth companies at prices that make sense. We believe that rewarding stock performance comes from companies with superior growth, attractive relative valuations, competitive strength, and financial integrity. Our decisions are based on fundamental analysis, which emphasizes bottom-up stock selection by sector specialists. We invest in all major market sectors because we believe that investment opportunities are found in industries that are frequently overlooked.

## Sector Insights

### Focus: Financials

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**Q: How does Rainier use its sector experts to manage a diversified portfolio?**

A: At all times we work in sector teams, sitting in the same room, where each Portfolio Manager is immersed in industry fundamentals. Sector teams consist of two or three people, each of whom acts as both Analyst and Portfolio Manager. The sector team identifies opportunities and makes recommendations to the larger equity team for final affirmation.

**Q: What is Rainier's approach to buying stocks in the financial sector?**

A: The financial sector is a major sector that has a particularly large representation in the Small/Mid and Mid Cap Equity strategies in light of their heavy weightings in pertinent indices. We prefer companies with strong balance sheets that have above average potential for growth. Across all sectors, we integrate quantitative tools with traditional fundamental analysis to assist in executing efficiently and select stocks with growth at prices that make sense. While we're not required to hold stocks in every industry in the financial sector, we prefer to have exposure in each if there are attractive opportunities.

**Q: How is the financial sector perceived in terms of being a "traditional growth" sector?**

A: While we believe opportunities for growth exist in all sectors, growth in the financial sector is somewhat unique because there is less room for innovation and constructive new product development in financial services relative to other sectors. Because of the lower opportunity for growth, we tend to historically be

underweight in financials relative to index benchmarks. That being said, we look for relative growth opportunities within each industry within the sector to identify companies that have the potential to outperform relative to their peers and the overall market. Depending on the stage of the market cycle, certain industries will be more favorable than others. Historically, this strategy has worked well, as financials have been a strong contributor to relative performance over time for Rainier.

**Q: Why does Rainier favor companies with strong balance sheets while searching for growth opportunities?**

A: We believe that companies with strong balance sheets are best positioned to experience growth over time for a number of reasons. Over a business cycle, companies that are more financially sound will tend to generate more free cash flow, have stronger capital bases, and be positioned to gain market share when new opportunities present themselves. They also have the resources to build new business lines that lead to future growth. Companies with distressed balance sheets are more constrained, aren't positioned to be opportunistic, and will need to go to the capital markets for additional funds when difficulties arise. For these reasons, we believe companies that exhibit financial strength are best positioned to grow in both the good times and the bad.

**Q: What are the major industries and what is the sector team looking for in their investigation?**

A: One of the most notable industries in the financial sector is banks. While we look at the price-to-earnings ratio for banks relative to the market, we also place emphasis on price-to-book ratios as well. By removing intangible assets, we can analyze the

price-to-tangible book value, which is another important measure of a bank's relative valuation. Another major factor we assess is the percentage of non-performing loans in the loan portfolio. We prefer companies that have a low level of non-performing loans and a relatively large reserve to offset future charge-offs, and we have developed tools internally that track directional changes in non-performing assets, loan loss reserves, and net interest margins. Companies that have historically written good loans and maintained an adequate reserve account are more likely to be able to weather future downturns. Financial conservatism in this area is an indicator that a company is disciplined and well positioned for the future. Another industry in the financial sector is property and casualty insurance. In this industry, there is very little that differentiates one company from another. This makes the search for growth more difficult, as the primary opportunity for differentiation is price. A unique characteristic of this industry is the unpredictability of natural disasters, which tend to drive rates up for insurers, and may lead to stock price appreciation. Because of the limited opportunities for growth in insurance, we are often underweight in this area relative to the benchmark.

Another industry that is typically not known for its high growth is real estate investment trusts (REITs). REITs are often bought more for their dividend yields than for their growth potential. An important metric used in analysis of this industry is price-to-funds from operation (a measure of cash flow). This industry is characterized by a high level of competition and limited differentiation, and driven largely by rent prices and occupancy rates. We are typically underinvested in REITs, although at times we may find this to be an area of relative growth given economic conditions.

At times there are significant opportunities in asset management firms. Growth in these companies is usually tied directly to the expansion of defined contribution plans and the level of the equity markets. Consolidation over time in this arena has created number of large organizations with economies of scale, leading to a significant increase in barriers to entry with fewer firms competing for a growing number of assets. As more companies attempt to increase their presence globally, international distribution is also an important factor to consider. Because equity markets tend to trend higher over time, there continue to be growth opportunities in asset managers and mutual fund companies.

Credit card companies represent another important industry. It is made up of a few major firms, so barriers to entry are extremely high. These companies tend to expand in line with consumer spending, and there is often more opportunity for actual revenue growth in this industry relative to others. The industry has evolved over time, as consumers increasingly pay for their purchases with credit and debit cards rather than checks or cash. This leads to increased earnings growth for credit card companies, with limited downside as the sponsoring banks are taking on the credit risk associated with the sales.

**Q: Are there any characteristics of the financial sector that differentiate it from the other sectors?**

A: The financial sector is unique in that its products are for the most part quite intangible. Most of the services that these companies provide are somewhat abstract, and can not be seen and touched as a computer or automobile can be. Another unique aspect of the sector is the variety in industries that it encompasses. Insurance companies, banks, broker-dealers and REITs all offer products that are quite different. These attributes make investing in the financial sector a bit different than investing in other sectors where many of the industries tend to be related and often the end products are used together.

**Q: Does the team foresee any lasting ramifications of the recent financial crisis on growth potential in this sector?**

A: One theme that seems to be prevalent throughout the sector is an increased emphasis on capital levels. Companies are working to strengthen their balance sheets in response to calls from regulators and investors to shore up capital. In the short term, there are opportunities in regional banks that are financially sound that have the opportunity to acquire distressed competitors with the assistance of the FDIC. In the long term this will mean decreased lending capacity, which will restrain economic growth as businesses seek capital to expand and grow. We believe this will lead to lower return on equity for banks in general, leading to less than normal growth in this area going forward. For this reason, we are generally underweight in banks relative to the relevant market indices.

**Q: How has Rainier navigated the market turmoil of the past few years, and how are the portfolios positioned in the financial sector for the future?**

A: While the upheaval in the global financial system has made investing in financials quite challenging as of late, Rainier had positioned itself well to manage the crisis as it ensued. Because of our emphasis on financial strength and sustainability, we were able to avoid the major financial institutions that were most exposed to toxic assets and had taken on excessive credit risk. As the economy has moved into recovery mode, investing in the financial sector hasn't gotten any easier. Some of the biggest winners in the sector recently have been distressed financial institutions that aren't projected to have positive earnings in the next year or so. At Rainier, we continue to focus on companies with strong growth opportunities in both the near and intermediate term that are reasonably priced. While focusing on quality companies at reasonable valuations does not always outperform when distressed companies are rallying in the short term, over time this process has proven to be successful. We have also emphasized stocks that have a broad exposure to capital markets, as they should realize strong earnings and improving fundamentals as the economic recovery continues to materialize.

*Next edition: Technology*

Price to Earnings (P/E) Ratio reflects the multiple of earnings at which a stock sells. Price to Book ratio (P/B) is used to compare a company's book value to its current market price. Price to Tangible Book Value shows the price of a security compared with its book value as reported in the company's balance sheet. Return on Equity is the ratio of net profit to total equity. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income. Price to cash flow is a stock's capitalization divided by its cash flow for the latest fiscal year. Free cash flow measures the financial performance of a company by subtracting capital expenditures from operating cash flow.

Fund holdings and sector allocation are subject to change and should not be considered a recommendation to buy or sell any security.

**Mutual fund investing involves risk. Principal loss is possible. Small- and mid-cap companies tend to have limited liquidity and greater price volatility than large-cap companies.**

*Performance data quoted represents past performance, which does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than quoted. For complete performance information current to the most recent quarter-end, please click on the fund name:*

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