



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: Producer Durables

Producer Durables sector specialists: James R. Margard, Peter M. Musser, Carlee J. Price

**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 to four people, each of whom acts as both analyst and portfolio manager. Investment decisions are evaluated and executed at the sector level, and are reviewed by the entire team. This serves to provide full visibility and input across the team and adds further layers of oversight to decisions.

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

A: The producer durables sector is a diverse group of industries with a large representation in each of our strategies as well as in the pertinent indices. We prefer to invest in companies with strong balance sheets that have above average potential for growth. We also place emphasis on companies that have a product or service that is differentiated, providing a distinct competitive advantage. 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.

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

A: It is important to note that growth and value labels tend to be fairly subjective, and over time opportunities for growth and value tend to migrate and shift as market conditions change. The producer

durables sector has not historically been viewed as a "traditional growth" sector; however, there have typically been pockets of growth within the sector. Recently, this sector has begun to take on more consistent growth characteristics. We believe that the growth in producer durables could potentially be as good as or better than other sectors of the market over the next few years. Much of this forecasted growth can be attributed to growth in the emerging world, as well as the late-cycle nature of most businesses in the underlying industries.

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

A: The producer durables sector is quite diverse, made up of a number of unique industries that are often unrelated. A common theme among the companies within the sector is their inherent cyclicity. As companies expand their international presence and move to become competitors on the global stage, they are increasingly sensitive to not only the U.S. economy but global economic conditions as well. That said, there are secular growth opportunities as well as companies with cyclical growth that should extend for a number of years.

The major industries within this sector include aerospace, transports, machinery, diversified manufacturing, and office supplies and equipment. A number of the companies in this sector are inter-related, while others have little in common. For example, transport companies purchase planes and equipment from aerospace and machinery companies that they will then operate. On the other hand, the sector also includes HR and consulting companies that are only loosely related to the more 'industrial' companies. A number

of large companies such as General Electric and 3M fall into the diversified manufacturing industry. We are generally cautious in this area, as industrial conglomerates are diverse so they tend not to be rewarded by the market in the same way that companies that are more focused in specific areas are.

Because of the cyclical nature of many companies within this sector, an important component of our analysis is understanding where the economy is in the business cycle. When analyzing individual companies from a bottom-up, fundamental perspective, the way each company performs in certain environments is key to our analysis. Due to the fact that the sector is driven mainly by corporate rather than consumer spending, companies have historically tended to recover less quickly in a period of economic recovery than those in the consumer discretionary sector, for example. While recoveries in consumer goods have been more coincident with economic conditions, corporations have usually waited longer to see proof of the recovery before committing capital to new investments. The planning, budgeting, and decision process also adds time. When an order is finally placed for a jet with Boeing, for example, it goes into the company's backlog. It will be years before the airline finally receives the finished product. Thus backlogs for companies in this sector are important to track, as the direction of backlog can have important implications for the company's future earnings. At times stock prices can be more affected by orders and backlogs than actual revenues due to the anticipation of future performance.

**Q: How were companies within this sector affected by the recent financial crisis?**

A: As economic conditions began to deteriorate globally at the onset of the financial crisis, demand in this sector dropped in an unprecedented way. While the drop in demand was steep, the duration turned out to be fairly short. Companies in the producer durables sector responded to lower demand by cutting their cost structures rapidly, which allowed many to initially increase profits despite lower revenues. Although revenues have in many cases been flat year over year, this cost cutting also allowed companies to return to close to peak-level profitability in a very short period of time. This has been most evident in the machinery/electrical equipment and commercial aerospace industries, as well as in certain areas of transportation, notably railroads and air freight. We are currently emphasizing companies in these industries, which have the potential to meet or exceed pre-recession peak levels of profitability in 2011.

**Q: Given the current environment, what types of companies are you currently favoring?**

A: An important characteristic of many of the companies we believe are poised to grow is that they are not dependent upon a turnaround in U.S. consumer demand to generate higher revenues. A large percentage of their revenues are either export-related or

are derived from participation in higher-growth industrializing countries in Asia and Latin America, such as China and Brazil. Companies with a higher percentage of fixed costs also have an operating leverage advantage given the improving economic environment. As demand returns, their margin improvement is amplified. The business services industry is an example of an area where variable cost structures may provide less opportunity for profit growth going forward, as most of these companies will have to hire additional employees to meet an increase in demand.

**Q: What major changes have you seen in this sector in the past ten years?**

A: One noteworthy change has taken place in the railroad industry, which looks completely different than it did ten or twenty years ago. This is an industry that was deregulated in the 1980s, and then proceeded to consolidate in the 1990s. But it was not until recently that these firms exercised their now significant pricing power. Whereas the railroads were once viewed as being similar to utilities due to high fixed costs, slow growth, and attractive yields, more recently this area has provided investors with substantial growth opportunities. At the same time, these companies have had to adjust their cost structures to become more competitive.

Because of these gains in market share and pricing power, along with extremely high barriers to entry in this industry, railroad companies have been able to maintain price increases throughout the downturn despite periodic declines in volumes. As economic conditions stabilize, the return of volumes combined with rising prices could mean amplified profitability for these companies.

**Q: Are there any industries within this sector that Rainier typically does not invest in?**

A: We are constantly looking for growth opportunities across all industries within the sector, but historically the portfolios have had little or no representation in the professional/business services industry. Companies in this industry are typically quite defensive, and rarely go through periods of sustainable overachievement in earnings growth. Because the barriers to entry are low in this industry, it is difficult for firms to establish a competitive advantage.

It is also rare for us to have significant positions in companies that are highly reliant on defense spending. In the last twenty years the trend has been toward cuts in the defense budget, and this is likely to continue as government becomes increasingly conscious of spending and the deficit. In an increasingly challenging pricing environment, these headwinds may mean limited growth opportunities for these companies going forward.

*Next edition: Consumer Discretionary*

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**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. Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.**

*The Funds investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus and summary prospectus contain this and other important information about the investment company, and may be obtained by calling 800.536.4640 or by visiting [www.rainierfunds.com](http://www.rainierfunds.com). Read carefully before investing.*

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