



Education

Equity Partners for Companies Primed to Become Public®

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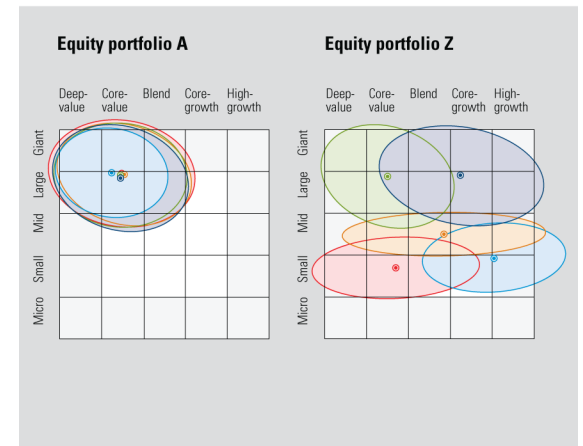
Vol. 2

Education Brief

Exploration in Diversification

Investors often wonder how many funds they need to reduce risk through diversification. The answer isn't a specific number of funds, but rather the holdings of each fund. If multiple funds in a portfolio have similar holdings, an investor can fail to achieve diversification benefits. Portfolio A and Portfolio Z in the image contain five mutual funds. Each oval represents the ownership zone, which accounts for 75% of the fund's holdings. The funds in Portfolio A overlap, indicating that each fund shares similar style characteristics. Too much overlap defeats the purpose of using multiple funds to create a diversified portfolio. Portfolio Z spans across many styles, so positive performance by some investments can neutralize the negative effect of others. As illustrated, it is important to be aware of the possibility of security overlap when constructing a diversified portfolio.

More Concentrated Portfolio Versus Diversified Portfolio



Diversification does not eliminate the risk of experiencing investment losses.

Source: Funds chosen from Morningstar's open-end database.



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About Keating Capital

Keating Capital, Inc. is a business development company that specializes in making pre-IPO investments in innovative, high growth private companies that are committed to and capable of becoming public. We provide individual investors with the ability to participate in a unique fund that invests in a private company's later stage, pre-IPO financing round — an opportunity

that has historically been reserved for institutional investors.

Keating Capital shares are traded on Nasdaq under the ticker symbol KIPO.

Portfolio Companies:

- *Agilyx
- *BrightSource Energy
- *Corsair Components
- *Harvest Power

- *Kabam
- *Livescribe
- *MBA Polymers
- *Metabolon
- *NeoPhotonics
- *Solazyme
- *Suniva
- *Tremor Video
- *TrueCar
- *XTime
- *Zook

Monthly Market Commentary

The S&P 500 has risen by almost 7% so far in 2012, causing investors to wonder whether the economy is slowly improving or whether this growth was merely the result of the January effect. Global economic news have generally been positive—it included China's slight drop in fourth-quarter GDP (as opposed to a plunge), a relatively quiet Europe, a positive U.S. employment/unemployment report, and the Federal Reserve's promise to extend low rates through 2014. Corporate earnings have so far been a mixed bag, and Morningstar economists believe that even as the U.S. economy continues to recover, earnings may continue to slow, especially for companies with significant exposure to China and Europe.

GDP: Real GDP grew by 2.8% in the fourth quarter, reflecting an overall positive trend in 2011. Consumer goods and inventories (GDP measures production, whether it is sold or simply sitting on a shelf somewhere) led this growth, contributing 1.3% and 1.9%, respectively, while government spending declined by 0.9%, mainly because of cuts in the defense budget. Morningstar economists believe that the 2.8% growth does not represent the new baseline for 2012, because the results were artificially boosted by unexpectedly good weather, the return of more normal auto production, inventory rebuilding, and shifts in retail employment.

Employment: Employment in January grew by an impressive 243,000 jobs, with 257,000 coming from the private sector, while the number of government jobs shrunk by 14,000. Although job growth rose across most sectors (only finance, information services, and government were down), the surprise came mainly from autos and durable goods, which benefited from favorable weather and large jumps in manufacturing and overtime hours, respectively. Retail also came as a surprise, as declines in seasonal hiring were offset by higher department-store and auto-showroom hiring, which boosted overall retail employment into growth territory.

Unemployment: The unemployment rate in January dropped to 8.3% from 8.5%. More important, this reduction came mostly from job growth as opposed to discouraged workers dropping out of the labor force or ceasing to claim benefits. To date, the U.S. economy has regained 41% of the 8.9 million private-sector jobs that were lost during the recession.

Manufacturing: The ISM Manufacturing survey reported better-than-expected numbers, indicating the third consecutive increase in the index and reflecting continued improvement in the auto industry. New durable-goods orders also rose much higher than expected in December, indicating that the manufacturing sector may be picking up steam and growing stronger.

Federal Reserve: The bold decision to keep interest rates low through late 2014 came as a surprise to many, and markets reacted positively to this unexpected news. Morningstar economists believe that continued low interest rates will actually start to pinch savers and hurt the personal income report in a meaningful way. Furthermore, this extended length of time does not lend any sense of urgency to either potential homebuyers or corporations considering large capital expenditures, further suppressing housing and private-sector growth. Given all the global economic uncertainty, there's almost no point in buying anything today when rates are guaranteed to stay low for the foreseeable future.

Despite the good employment news, the overall outlook remains far from optimistic. Rising prices and stagnant incomes put pressure on savings, while the low interest rate environment offers little yield as stocks continue to struggle. Although everybody is hoping for economic growth, the question remains—where will that growth come from?

A Quick Guide to Leading Economic Indicators

Turn on CNBC on any given day and you are bound to hear about various economic indicators and how they might affect the markets. Although we believe in investing with a long-term horizon, investors should learn what the key economic indicators mean and how they could potentially affect one's portfolio.

Leading indicators are economic indicators that anticipate a change in the direction of the economy and are useful as short-term predictors. Some of these include the returns on the S&P 500 Index, consumer sentiment and expectations, changes in the employment rate, and production levels in the manufacturing sectors.

The unemployment rate represents the percentage of the working population that does not have a job, have actively looked for work in the prior four weeks, or are waiting to be rehired to a job from which they had been temporarily laid off. This figure is seasonally adjusted to reflect the impact of predictable seasonal patterns. In addition to the overall unemployment figure that is often quoted in the media, data on sector-specific unemployment figures can be obtained from the U.S. Bureau of Labor Statistics. For example, in December 2010, there were gains of 12,000 retail jobs while the construction sector lost 16,000 jobs. These figures can be important for investors who wish to invest in sector-specific ETFs, or are looking to increase their portfolio exposure to a specific sector.

Average workweek hours looks at the productivity of the workforce. In the past few quarters, statistics have shown that companies have been cutting costs by getting their existing employees to work longer hours, instead of rehiring laid off workers. In addition, the U.S. Bureau of Labor Statistics provides quarterly statistics on output per hour and productivity. Typically, in an economic recovery, real wages increase first, followed by hours worked, and finally employment. Given that there are only so many techniques that companies can use to increase

productivity out of workers, further increases in production will eventually result in an increase in employment. This indicator is a good gauge for overall business confidence sentiment.

The University of Michigan Consumer Sentiment Index is created using results from approximately 500 telephone interviews conducted each month. The index is used to forecast spending behavior and economic expectations of consumers, and consumer attitudes on savings, spending, and the business climate. It is frequently cited that consumer spending accounts for about 70% of the GDP in the United States and thus, is an important indicator especially if you are heavily invested in the consumer cyclical sector, in areas like the restaurant, retail, and travel industry.

Both the Chicago Purchasing Managers Index (PMI) and the Institute for Supply Management Index (ISM) look at economic activity in the manufacturing sector based on factors such as production, inventories, new orders, and exports and imports. These statistics are particularly important to investors who wish to seek exposure to the industrials or basic material sectors. However, investors should also take note that manufacturing activity increases because of increased consumer demand, and has been a shrinking portion of our GDP, as compared to the services sector.

The returns on the S&P 500 Index are also regarded as a leading economic indicator. This index includes 500 of the largest publicly listed companies in the U.S., comprising 75% of all U.S. equities. It is considered a leading indicator because changes in stock prices might reflect investor's expectations for the future of the economy.

Past performance is not indicative of future results. Returns and principal invested in stocks are not guaranteed. Sector investments are narrowly focused investments that typically exhibit higher volatility than the market in general.

Dangers of Market Timing

Two of the most dangerous words in the investing world are “market timing.” Market timing occurs when investors try to predict which direction the stock market will head. While some investors have been known to make money timing the market, it is highly inadvisable for long-term investors to try this extremely risky strategy. Opponents of Market Timing: Most investors and academics believe it is impossible to forecast market movements. Such a technique amounts to gambling when compared with a sound investment approach. It fails far more than it works, and market timers often end up buying high and selling low. Furthermore, you run the risk of missing periods of exceptional returns. For example, over the past 20 years, a \$1 investment in stocks, as represented by the Standard & Poor’s 500®, would have grown to \$5.75. If that same \$1 investment happened to miss the best 13 months of stock returns over the past 20 years, the ending value would have equaled only \$1.96. This would have been less than the value for an investor in a 30-day Treasury bill, a.k.a. cash, \$1.97. Only those who

remained invested in stocks throughout the entire period were sure to get market exposure during the crucial hot months.

Advocates of Market Timing: On the contrary, a number of websites, newsletters, and other trading services boast they can time the market. While their returns may have in fact beaten the market by a considerable margin, it’s safe to assume that these systems can’t consistently hold up over the long term. On some occasions and during some stretches of time, market timing can help generate impressive profits. However, you must be familiar with the dangers behind such an approach.

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