

INVESTMENT PANEL

Editor's Note: The Investment Panel feature appears regularly in our Financial Quarterly publication, spotlighting area investment professionals and their views on the markets and investments. In this issue, we chat with Jim Burns and John Lombardo.

We interviewed them separately via telephone, but asked the same questions.



James (Jim) Burns, president of J.W. Burns & Company in DeWitt.

Burns



John Lombardo, chief investment officer at Blue Water Capital Management, LLC in Syracuse.

Lombardo

Business Journal: What is your view on where the financial markets are headed in the coming months?

Burns: Well, as you know, we are heading into a hotly contested presidential election, with very competitive Senate and House races as well. Because the economic recovery in the United States depends, to a large extent, on confidence in the direction of our fiscal policy, which will be determined by the election, it is my best guess that we have a volatile few months ahead of us.

From a longer-term perspective, the key concern for investors remains growth, or the lack thereof. It is clear that the recent economic data has been deteriorating. The U.S. economy is struggling to get to what some people call "escape velocity," that is, our domestic economy developing enough momentum for the recovery to be self-sustaining. However, considering all the negative headlines that have confronted investors — including stubbornly high unemployment

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FINANCIAL QUARTERLY

Cover Story

Beacon acquisition makes Berkshire Hills a player in Central New York



Editor's Note: The Newsmaker Interview portion of *Financial Quarterly* features a conversation with a CEO of a major Central New York business every quarter. The story discusses key financial issues affecting the newsmaker's company and industry.

BY KEVIN TAMPONE
JOURNAL STAFF

DeWITT — A new bank is moving into the region in a big way.

Berkshire Hills Bancorp, Inc. (NASDAQ: BHLB), parent company of Berkshire Bank, unveiled in May its plans to acquire DeWitt-based Beacon Federal Bancorp, Inc. (NASDAQ: BFED) in a \$132 million deal. That follows Berkshire's acquisition of Rome Savings Bank last year, its first entry into Central New York.

Berkshire has been targeting the region, says Sean Gray, Berkshire's executive vice president for retail banking. Syracuse is an especially key market within that broader footprint, he adds.

The region mirrors some of the characteristics of other markets where Berkshire has had success, such as Albany, Gray says. The bank started opening branches in the Albany area about seven years ago, he adds.

Headquartered in Pittsfield, Mass., Berkshire Hills has \$4.3 billion in assets and 68 branches in Massachusetts, New York, Connecticut, and Vermont.

Beacon Federal has total assets of \$1 billion and branches in DeWitt, Marcy, and Rome; Smartt and Smyrna, Tenn.; and Chelmsford, Mass. A subsidiary, Beacon Comprehensive Services Corp., provides investments, insurance, tax preparation.

Future acquisitions and branch openings are possible for Berkshire in Central New York, Casey says. The bank could look to fill in its footprint between Rome and Syracuse and Albany in the future.

Much of Berkshire's focus in the immediate future will be on its current operations in the region, Gray notes.

"Right now, Syracuse is one of the largest markets we operate in [for] the whole bank," he says. "That requires our effort and energy and concentration."

Gray says he can envision Beacon Federal becoming a hub for Berkshire's consumer business throughout its footprint.



Sean Gray

Beacon Federal is strong in auto lending and other consumer-oriented products, he says.

Berkshire's commercial and business-related products should provide a boost for Beacon Federal, he adds.

Berkshire leaders haven't made any decisions on job cuts, Gray says, but plan to look for duplication of positions as the acquisition nears completion. Beacon Federal employs more than 140 people and Berkshire has 760 employees.

Berkshire is planning to divest Beacon's branches in Tennessee, which it says would involve \$57 million in deposits and \$98 million in loans. Berkshire is also expecting cost savings of 30 percent with the deal.

Gray says the long-term plan is to grow Berkshire in Beacon's geographic footprint. "They know the markets,"

he says of Beacon's employees. "There's a lot of folks with incredible tenures."

The acquisition is continuing despite a report from a federal regulator of unsafe banking practices at Beacon Federal. The bank and the federal Office of the Comptroller of the Currency (OCC) signed an agreement recently, outlining actions to address the issues the regulator found.

The regulator found "unsafe and unsound" banking practices at Beacon Federal, according to filings with the U.S. Securities and Exchange Commission, but the documents did not discuss the details.

Among other things, Beacon Federal agreed to implement a three-year business plan and review the qualifications of all its senior executive officers.

The bank must also establish new risk-management practices, diversify its assets, improve internal controls on its commercial-lending activities, and review and revise its loan policy. In addition, the regulator imposed specific capital requirements on the bank.

The agreement stems from an OCC examination that began last October. It was the first for the bank with the OCC, according to Beacon Federal. □

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Inside Stuff

New Office:

- Oswego County FCU is building a new office.

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FQ DATA FILE

- See charts on the regional housing market (Page 2B), jobs (page 5B), and airport-passenger traffic (Page 8B).



PANEL: *More mistakes are made when you have to have an above-average return on your assets*

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here at home, Europe's economic mess, the looming U.S. fiscal cliff, and China's economic slowdown — the fact that the S&P 500 Index is up over 10 percent year-to-date [as of press time] seems to imply the valuations on stocks remain attractive. And if growth can be sustained, even moderate growth, then the global investment landscape does offer many opportunities.

Lombardo: We suspect we probably have seen the highs for the year in the first quarter. The market is facing a lot of headwinds. Challenges would include significantly slower growth in China, recession in a number of European economies, and uneven economic and employment growth in the U.S. Also, slowing revenue and profit growth at American corporations is another challenge. What we've seen already this earnings season is the expectation for 2012 S&P 500 earnings growth has dropped by about 2.5 percent basically in the last few weeks since earnings season started. A number of companies have guided analysts' earnings estimates lower.

These challenges are likely to result in a choppy market environment. It's a market that's likely to respond to both positive and negative headlines on a given day, creating a rather volatile market landscape.

Business Journal: What's your view on the role central bankers and the U.S. fiscal cliff will play in the markets going forward?

Burns: With regards to the central banks, it is obvious that "risk-on" assets — such as stocks, high-yield bonds, and commodities — respond favorably to central-bank efforts to stimulate the economy. Over the last few years, every liquidity intervention by the Federal Reserve has resulted in a significant rally for stocks and other growth-oriented assets. The more serious question that longer-term investors need to consider is how many more "bullets" the Federal Reserve has to stimulate the economy when the economic data weakens, as it has at various points each of the last three years. Interest rates are, as everyone knows, about as low as they can get, so the bond-buying programs that the Federal Reserve embarks on are probably losing their impact over time. So, the issue comes back to "escape velocity" or healthier economic momentum and growth, and this has yet to take hold in the United States or globally. The key issue for investors, as I stated earlier, remains sustainable economic growth.

In terms of the "fiscal cliff," which is a term Ben Bernanke used to dramatically describe the combination of the expiring of the Bush tax cuts and the massive, automatic government spending cuts, it is simply too early to really forecast what could happen. There are various scenarios that could play out and again, much of this depends on the election results. From an investment standpoint, I counsel my clients that they should take a relatively

defensive positioning within their portfolios because the downside risk should no deal be reached is probably greater than the potential upside should a miraculous "grand bargain" be agreed upon by the two major political parties.

Lombardo: I would suggest that you're going to see central banks add to the volatility we see in the markets. We think central bankers have been a big part of the so-called risk-on/risk-off trade. To the extent that further economic weakness results in an additional quantitative-easing program by the Federal Reserve and the debt crisis in Europe results in additional easing by the European Central Bank, we are likely to see that type of trade continue. It seems that what we've seen is that when the Fed does easing we get a rally until that easing ends and then a selloff after it. So, it has an imperfect and less-than-permanent impact. You see these quantitative-easing rounds have less impact and less long-lasting effects on the markets than before.

Our suspicion is that serious action to reduce the fiscal cliff won't occur until after the elections. So, the effect will happen late in the year because we don't expect the sides to come together based on the pattern of action we've seen the last two years in Washington, D.C.

Ultimately, what we do expect is the size of the fiscal impact will be reduced but it will be felt early next year. Given that the economy is already slowing and that global growth is slowing, fiscal contraction is increasing the odds of recession beginning late this year and into the first half of next year.

Business Journal: Provide specific recommendations for investments that clients should be making right now.

Burns: I think investors overall should continue to focus on what I term the three Ds of successful investing: Diversified, Dividends, and Defensive.

The demand for living income is part of what is pushing up the prices of dividend-paying stocks and various higher-income generating fixed-income securities.

Along these lines, we're quite bullish on Novartis (ticker: NVS). It has a diverse product line, including its own patented drugs, generic drugs, pet pharmaceuticals, and a strong dividend yield of about 4.2 percent.

In terms of growth and dividends, we continue to like Apple (ticker: AAPL). It just had an uncharacteristic earnings miss, primarily due to weaker iPhone sales in Europe. That being said, both Apple's earnings and revenues were up more than 30 percent year over year. And with the stock selling at about 14 times earnings, to us this is a relatively low-risk opportunity. Most importantly, Apple has huge product releases coming up, especially the iPhone 5 and the new Apple TV.

Finally, my last pick is Chevron (ticker: CVX), which we have owned in our client portfolios for years. It just had a very strong earnings report, earning \$7.2 billion in the second quarter on \$60 billion in revenue. This is in a period of deteriorating confidence in the European economic situation, which hurt energy prices, and you had a significant decline in the second quarter across the board in energy stocks. However, Chevron is a defensive energy

stock and its price held up quite well. It currently yields around 3.2 percent.

Lombardo: We are asset allocators, so we believe in building a well-diversified portfolio. However, given our concerns about economic growth in general and the challenges in Europe specifically, we believe most investors should reduce their risk exposure. And specifically where they take on risk in their portfolio, it makes sense to substitute exposure higher up the capital structure into high-yield bonds or bonds of emerging governments for some of their traditional, what had been equity exposure. You're going to want to substitute. It's also an environment where exposure to non-traditional strategies, what might typically be considered hedge-like strategies, are an appropriate part of portfolio construction to reduce the risk in the portfolio. Currently, we utilize the Evercore Wealth Management Macro Opportunity Fund. The aim of the fund is to hedge the risks to a traditional balanced allocation for U.S.-dollar based investors.

Within high-yield, we prefer the long-short approach because bonds have an asymmetric risk structure. We utilize an outside manager that both buys and sells short bonds.

Business Journal: What do you see as the greatest risks investors need to be aware of and seek to avoid in the coming months?

Burns: I would say there are two primary risks that seem to catch investors repeatedly. The first is a lack of diversification, or stated another way, the concentration of their portfolio in either risky, or, at the other end of the spectrum, concentrated in risk-free assets, such as cash. I will acknowledge that the headlines that investors are faced with can be frightening. As a result, they can be whipsawed by trying to time the market and either sell out of growth-oriented assets when the outlook is poor, or get very aggressive when markets are doing well. Therefore, investors have to remain diversified and balanced.

The second risk is forcing investment returns that may not be there. If you have not saved enough for retirement and are demanding a 6 percent to 7 percent annualized return over the next five to 10 years, let me suggest that you go back to work or adjust your lifestyle accordingly. More mistakes are made when you have to have an above-average return on your assets. It is clear that we live in challenging economic times, so it is vital that investors accept this and have mature and realistic expectations.

As the late investment author Peter Bernstein once said, "The market is not a very accommodating machine. It won't provide you high returns just because you need them."

Lombardo: The greatest risks that investors are facing are ... the risk of continued slowing in a global economy, coupled with the risk associated with instability in Europe. Of course, both of these risks tend to reinforce one another. This suggests a more defensive posture to a portfolio in our minds, because the risk to a downside surprise in the markets carries a significantly higher probability than the risk of an upside surprise. □

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