Small- and Mid-Cap Core

Fourth Quarter 2007
Investment Update

Third quarter stock market trends continued through the fourth quarter. The market wrestled with the fall out of the housing market, the debt market crisis and the spillover effects they would have on both the U.S. and global economies. On top of these issues, oil flirted with the $100 level before finally breaking through $100 in early January. This combination made for a difficult holiday shopping season for consumers and the market began to fear that the U.S. was slipping into a recession. The Fed moved to address the situation through coordinated efforts with other central banks to inject liquidity into the market and by cutting interest rates in October and December. Although the market initially strengthened on the news, it quickly reversed reflecting a belief that the Fed was late and ineffective in averting an economic downturn. The contradictory forces of a slowing economy and inflation above the Fed's target make it difficult for the Fed to act aggressively. Against this backdrop, the market finished the last quarter of the year down across market cap sizes with large cap stocks slightly outperforming mid and small caps.

Small Cap Core: In a market where valuation took a back seat to the momentum generated from news flow, our investment style continued to struggle. We underperformed the Russell 2000 by more than 500 basis points for the quarter and finished the year roughly 400 basis points behind the index.

The Russell 2000 declined (4.6%) for the quarter and once again growth outperformed value with the Russell 2000 Growth Index declining (2.1%) and the Russell 2000 Value Index down (7.3%). For the year, growth outperformed value by almost 1,700 basis points rising 7.0% compared to a (9.8%) decline for the value index. The spread between the growth index and the value index was the third largest on record and the first year of relative outperformance since 1999. For the December quarter, only four of the eleven economic sectors had positive returns. Energy and healthcare were the best performing sectors up 4.4% and 3.2% respectively. Utilities and producer durables eked out positive returns of less than 1%. The worst performing sectors from a contribution standpoint were consumer discretionary and financial services which were down (9.3%) and (8.6%). The smaller auto & transportation and REIT sectors were down significantly returning (13.5%) and (9.2%), respectively. Technology declined (6.4%).

Most of our underperformance relative to the Russell 2000 occurred in our technology and health care stocks. Our stock picks in financial services and autos and transportation were our biggest positive contributor relative to the benchmark.

Mid Cap Core: In a market where valuation took a back seat to the momentum generated from news flow, our investment style held its own for the fourth quarter, finishing a strong year. We underperformed the Russell Mid Cap Index by a little less than 100 basis points for the quarter and finished the year roughly 680 basis points ahead of the index.

The Russell Midcap Index declined (3.6%) for the quarter. Growth outperformed value in the quarter as the Russell Midcap Growth Index declined (1.7%) compared to the Russell Midcap Value index which was down (6.0%). For the year, growth outperformed value by 1,285 basis points. This was the first year of relative outperformance since 1999. For the December quarter, only two of the eleven economic sectors had positive returns. Energy and materials and processing were up 11.4% and 1.6% respectively. The worst performing sectors from a contribution standpoint were consumer discretionary and financial services which were down (8.8%) and (7.7%). The smaller auto & transportation and REIT sectors were down significantly returning (12.6%) and (9.8%), respectively. Technology declined (6.3%).

Our stock picks in financial services, producer durables, consumer discretionary and utilities all contributed positively relative to the Russell Midcap. Underperformance relative to the benchmark occurred in materials and processing, and technology sectors.

We have had a cautious view on the U.S. economy but as a recession begins to become consensus thinking and the market discounts it, we are looking ahead to when the economy will improve and will position the portfolio in stocks that will lead the market up. We added eight names to the small cap portfolio and nine names to the mid cap portfolio in the fourth quarter which we think will add value over the next 12-18 months. Although the market has been challenging over the last two quarters, we continue to have confidence in our investment process and we will continue to adhere to it as we have done in the past.