Evercore | Asset Management

Fourth Quarter 2009
Investment Update

Well, what a difference a year makes. We're not making reference to the market's sharp upward turn since early 2009, although that was certainly noteworthy. Nor are we taking note of the broad economy's "stabilization" or the price of gold or the fall of the dollar against most major currencies. We're not even talking about the performance of our portfolios, which were very strong across the board.

Instead, we are referring to the contraction in equity risk spreads, which have fallen from approximately four standard deviations above normal in March of 2009 to near normal today.

For our core services, the shrinking payoff for taking risk shows up in our proprietary "reward to risk" calculation. Currently, the figure for our average holding is in the 3.5x range. A year ago, it was closer to 6x.

We are focused on these metrics because the contraction poses a dilemma related to the trade-off between risk and reward. When valuation spreads were very wide, we argued strongly that it paid to concentrate our portfolios in the most controversial areas of the market: companies that, rightly or wrongly, investors considered closest to the eye of the economic storm.

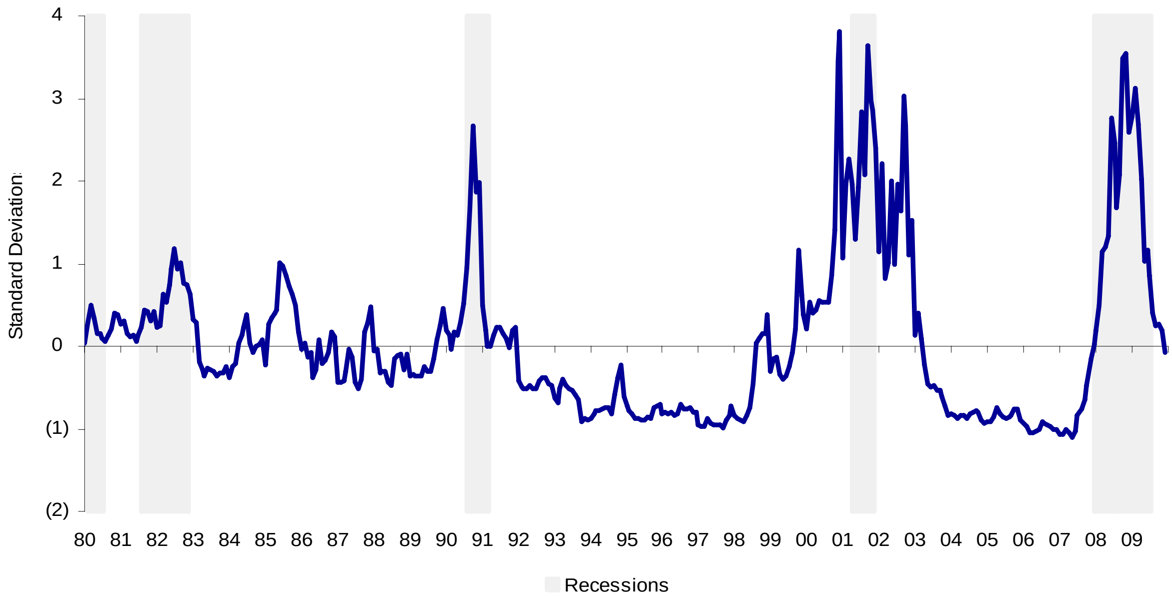
Our Firm

At Evercore Asset Management we focus first and foremost on achieving superior returns for our clients. We build concentrated portfolios of small- and mid-cap companies, one stock at a time, through extensive fundamental research. Our portfolios consist only of companies that we believe have outsized opportunity to appreciate in value. We strive to build long-lasting client relationships through consistent portfolio management and timely, straightforward communication.

We couldn't know for certain that our estimates of the long term earnings power of these companies were correct, but we were confident that our research was thorough and thoughtful. We also knew that if we were right, our clients would be rewarded with a very large payoff. If ever there was a time to be greedy when others were fearful, that was it. We concentrated our portfolios accordingly, and the results have been gratifying.

The world looks different today, though. The payoff for embracing riskier assets has largely been realized as investors' anxiety that our economy and financial system were about to go over the proverbial cliff has abated. The market has experienced a significant P/E expansion, even in the face of very little earnings growth. To be sure, risk spreads that are about average still provide an environment in which alpha can be created; it's just not the same as the four standard deviation opportunity we had nine short months ago (Chart 1).

Chart 1: Equity Valuation Spreads – Top Quintile to Market Average



Source: Empirical Research Partners Analysis, National Bureau of Economic Research. Data through December 31, 2009

Responsible portfolio management is a continuous exercise in balancing the safety afforded by diversification against the risk that normally accompanies high expected investment returns. As we contemplate the appropriate balance for our clients' portfolios, a major factor in our thinking is our uncertainty about the sustainability of the nascent economic recovery.

Our concern on this front is not based on the extraordinary length or depth of the recession, or the "jobless" recovery (a moniker that also was attached to the recessions of '90-91 and '01-02). Instead our concern hinges on the degree to which we ought to characterize this recession as something other than an unusually bad cyclical event.

On the surface, that appears to be a fair characterization. As in prior downturns, there was excessive capital investment. This time the excess investment took place largely in the housing sector rather than the industrial sector, but the result was the same: too many investment projects were undertaken that were not financially viable. Too many homes were built, too many were purchased at prices the owners couldn't afford, and too much debt was incurred to do it all. In an oversimplified sense, consumers, egged on by Wall Street, borrowed more than they could afford, used the proceeds to go on a shopping spree and are now defaulting on the resultant obligations. Also egged on by Wall Street, investors around the world have been left holding the bag, having been duped into purchasing the now defaulting loans through the deft hand of financial wizardry. However tawdry and regrettable it all may have been, if that's the whole story then we can expect that once balance sheets have been repaired and excess inventory has been worked off, life as we had come to know it ought to resume fairly promptly.

There is, however, another, more threatening interpretation of the economic and financial events of the last few years, and that is that the burst of the housing bubble has finally revealed the results of the intersection of certain economic and societal trends that have been underway for 25 years or more, during which manufacturing jobs moved overseas, leaving behind an ill-prepared segment of the workforce whose income generating ability is simply not what it used to be. For a time, many such workers were able to borrow to maintain their standard of living, thanks to more than two decades of low interest rates, soaring equity markets, and, most recently, bubbly housing prices. Now that the jig is up, we are left to confront the distinct possibility that we face serious structural problems in our economy that will be difficult to solve. There are millions of workers who once made a living building or selling houses, but many of those jobs are not coming back. Millions more made cars and car parts and furniture and mining and construction equipment—but employment in those sectors will not return to pre-bubble levels for years and years to come. Labor markets have always had to adjust to changing economic conditions, but the rapidity and magnitude of this downturn may require a longer and more painful adaptation than this country has experienced since the Great Depression.

Working to our advantage is that our workforce today is dramatically more mobile and information is far more easily disseminated than was the case during the Depression. The dollar is weakening, and our trade partners and the holders of US debt still have sufficient confidence so that inflation and long-term interest rates are not rising. These are all important factors in the equation, but it is beyond our ability to forecast with any certainty how the macroeconomic situation will ultimately unfold.

A year ago, the appropriate stance for us was obvious. Today it requires us to examine multiple scenarios, and as always to rely on the depth and quality of our investment research. We are doing our best to take advantage of the risk spreads which remain while balancing the concern that this recovery may be less predictable than those of the past. Below we discuss what worked and what did not work for us in 4Q'09 and how we have positioned our portfolios for this next, less certain phase. As downbeat as all of this sounds, there is a glass-half-full scenario—uncertainty can be an important and positive force in creating opportunity for focused and nimble investors.

Portfolio Strategy: Small- and Mid-Cap Core

The year 2009, although a bit of a roller coaster, proved to be a very good year for equity investors rewarding bottom up stock pickers with superior performance. Our Small-Cap Core portfolio returned 7.8% net of fees for the quarter, exceeding the Russell 2000 Index by about 400 basis points*. For the full year 2009, our client's portfolios were up 43.3% net of fees compared to 27.2% for the Russell 2000 Index—capping one of the best years of absolute and relative performance in our history*. The Mid-Cap Core portfolio lagged its index for 4Q'09, but was up 40.6% net of fees for the year compared to the 40.5% return achieved for the Russell Mid-Cap Index*. The Russell Midcap Index proved to be a very tough index to beat as mid-cap equities were the best performing domestic equity asset class for 2009.

*For notes on performance please refer to the disclosures at the end of this presentation

One of the biggest differences in the investment climate today compared to a year ago is the involvement of governments across the world. Whether it was bailout packages put in place for financial institutions and auto companies, stimulus packages to help the economy recover and begin to grow, or the healthcare reform debate in the U.S., governments took a far more active role in managing the economy than they had in the past. This new involvement presented both opportunities and risks for investors. We viewed the rules for banks accepting government money to be fairly fluid and we struggled for most of the year to find investment opportunities in regional banks which met all of our investment criteria. However, the sell-off in Health Care and education stocks as Congress discussed reform and regulation, respectively, gave us an opportunity to add attractive investments to our portfolio. Our fundamental research in these areas showed that even in a new regulatory environment, there would be catalysts that would permit individual companies to continue to grow earnings going forward.

For example, in the fourth quarter several of our Health Care investments were among our best performers. Returns for this group fell into two different categories: **Conmed (CNMD)**, **Perrigo (PRGO)**, **AmeriSourceBergen (ABC)** and **Hospira (HSP)** all reported strong earnings in the quarter and provided positive forward guidance resulting in significant stock appreciation. For Conmed and Perrigo we exited our profitable positions as the reward/risk in both cases was no longer attractive. However, we continue to hold AmeriSourceBergen and Hospira as we believe there is potential for further appreciation. Also contributing meaningfully to performance were two newly added stocks **Aetna (AET)** and **Healthspring (HS)**. Early in the quarter we purchased Aetna and Healthspring as the health care reform debate dragged on in Washington. These two insurance companies were cheap because the market viewed health reform as being detrimental to their businesses. On the other hand, we thought the news was more than priced into the stocks and that their business going forward would prove to be resilient. Both stocks were strong performers after we purchased them as the market also began to understand that the companies could continue to thrive in the new environment.

The large amounts of global stimulus pumped into the system caused investors to look for economic reflation trades that would benefit from a recovery in the emerging economies such as China and India. Our portfolios benefitted from this market shift as several companies, which we discuss below, have commodity exposure in their business mix. Our consumer focused companies, **Smithfield Foods (SFD)** and **Darling International (DAR)**, both outperformed the market on the strengthening outlook for agricultural and food byproduct pricing. **U.S. Steel (X)** was our best performing Mid-Cap Core stock as the outlook for steel prices became more favorable on improved global expansion and a rebound in the auto sector. Lastly, **Newpark Resources (NR)** was one of our larger contributors to Small-Cap performance. Newpark, an oil service company that produces drilling fluids, was a name we added to the portfolio late in the third quarter after the market was disappointed because a new contract in Brazil initially proved to be unprofitable. We met with management and believed the contract was merely in the ramp-up phase and would meet profit targets. At the same time, Newpark has developed new fluids technology for shale drilling in the United States which is attracting interest from a number of customers as they increase their drilling budgets due to rising commodity prices. Our average cost in the stock is below book value and we believe there is substantial upside as the company gains share with its new technology and returns to profitability.

Despite the Technology sector's leverage to the same forces that were driving our commodity stocks higher, the performance of both portfolios was hurt by our technology investments. In Small-Cap Core, **Zoran (ZRAN)** and **Harris Stratex (HSTX)** were down marginally in an up market. In Mid-Cap Core, **MEMC Electronics (WFR)** underperformed substantially due to a disappointing earnings report. We continue to like MEMC and have added to our position at a price slightly above book value on the belief that both its business and the stock are extremely attractive at current prices. MEMC has made some recent investments to better position the company going forward. We believe these investments will allow the company to have better control of the production, marketing and distribution of its polysilicon wafers and thus improve its earnings power going forward.

We believe we are still in a stock picker's market and that our portfolios will continue to do well in this environment. Despite the already strong move in the equity market, we are finding attractive investments across a wide array of industries. Our VCM research process—valuation, catalyst, management—has identified five new names for both our Small- and Mid-Cap Core portfolios. These names came from diverse sectors including Transportation, Health Care, Chemicals, Financials, Retail, Technology and Business Services. All of the names had reward/risk ratios well in excess of our 2x hurdle, with attainable catalysts and with management teams we felt confident would execute well. A good example of a recent Small-Cap purchase is **Team Inc. (TISI),** an industrial services company exposed to the energy and petrochemical space which will benefit from improved capacity utilization rates in the US. We initiated the position after the stock had fallen 45% because its customers were delaying needed maintenance. The stock was trading at P/E ratio of roughly 13x next year's earnings compared to an historical multiple in excess of 20x. Team is well positioned for a solid earnings recovery when its customers' budgets ramp back up and as it gains market share at the bottom of the cycle.

Performance & Characteristics: Small- and Mid-Cap Core

	Periods Ending 12/31/2009				
Performance	MRQ	YTD	1Year	3Year	5Year
Small-Cap Core	**7.8%**	**43.3%**	**43.3%**	**-2.2%**	**4.2%**
Russell 2000®	3.9	27.2	27.2	-6.1	0.5
Excess Return	3.9	16.1	16.1	3.9	3.7
Mid-Cap Core	**2.3**	**40.6**	**40.6**	**-3.9**	**4.8**
Russell Midcap®	5.9	40.5	40.5	-4.6	2.4
Excess Return	-3.6	0.1	0.1	0.7	2.4

Net of management fees

Periods greater than one year are annualized

For notes on performance please refer to the disclosure at the end of this document

Portfolio Characteristics	Small-Cap Core	Mid-Cap Core
P/E (ex. negative earnings)	19.0x	19.6x
P/B	1.5x	1.7x
Dividend Yield	0.8%	1.3%
Wtd. Avg. Market Cap.	$1,185 mm	$6,814 mm
Number of Holdings	36	33

Source: Evercore Asset Management and BNY Mellon Asset Servicing

Disclosures

The securities discussed above were holdings during the quarter ended December 31, 2009. The stocks we elect to highlight each quarter will not always be the highest performing stocks in the portfolio, but rather will have had some reported news or event (e.g. new contract, acquisition/divestiture, financing/refinancing, revenue or earnings, changes to management, change in relative valuation, plant strike, product recall, court ruling, etc.) of significance. They do not represent all of the securities purchased, sold or recommended by the advisor, and the reader should not assume that investments in the securities identified and discussed were or will be profitable. All information is provided for informational purposes only and should not be deemed a recommendation to buy the securities mentioned.

All investments involve risk including the loss of principal. The performance and volatility of an index may be materially different from that of a client's account. In addition, a client's holdings may differ significantly from the securities that comprise an index. The indexes have not been selected to represent an appropriate benchmark to compare the advisor's performance, but rather are disclosed to allow for comparison of the advisor's performance to that of a well-known and widely recognized index.

Core Performance Disclosures:

1. The Small-Cap Core and Mid-Cap Core Composites comprise discretionary accounts with no material investment restrictions. Net of fee performance results reflect the deduction of fees according to the applicable investment advisory fee schedule. The results include all interest, realized and accrued dividends, capital gains, capital losses and brokerage commissions. Composite results prior to February 1, 2009 are based on aggregated data at the product level. Results following that date are based on asset weighted returns. Asset weighted performance measures the average performance of all portfolios in the composite weighted by size. Performance results for individual accounts vary due to the timing of investments, additions/withdrawals, length of relationship, and size of positions, among other reasons. Past performance is no guarantee of future results.

2. Composite Inclusion: Accounts that are fully invested as of the last day of the month are added to the Small-Cap Core and Mid-Cap Core composites at the beginning of the following month. Composites include terminated accounts for all full months under management.