

First Quarter 2009 Investment Update

For Evercore Asset Management, the big news in 2009's first quarter was our acquisition of a deeply experienced small- and mid-cap core team based in Boston. Led by Chris Fasciano, the team of five investors has a very long, and very good, track record of managing small- and mid-cap core portfolios for institutional clients. Through the five years ending in March 2009, the Small-Cap Core portfolio has outperformed its benchmark by 1.9% net of fees while the Mid-Cap Core portfolio has achieved a premium of 3.1% relative to its benchmark. Performance is similarly strong over both shorter and longer term periods.

From our perspective, the acquisition was an opportunity to expand our current Small- and SMID-Cap Deep Value offerings in a logical way. Like our Deep Value team led by Andrew Moloff, Chris and his team manage their portfolios in a strictly bottom-up fashion, using fundamental research to select just 35 to 45 high conviction holdings. While our existing deep value approach puts an over-riding premium on cheapness, the core portfolios seek to balance attractive valuations with specific catalysts that will allow value realization over the next 6 to 12 months. The team's evaluation of management and their ability to execute is the third critical element of the process.

The Core team will continue to manage portfolios from their Boston office as they always have, while EAM will provide the team with marketing and client service support as well as the full range of back and middle office operations. If you might have an interest in either of our core products, we'd encourage you to give us a call.

On the investing front, the first quarter of 2009 saw both good and bad extremes with a bullish first ten days quickly followed by a return of the late 2008 market collapse and, finally, a very sharp rally to close the quarter. We take some heart from the strong results achieved by all of our investment services in March and April, mostly because our portfolios behaved in a manner which we think provides a glimpse into their imbedded latent performance potential. Market inflection points are very tricky to gauge, but our hope is that investors in "stepping back off the ledge" will become a bit more rational, and as they do, will again give greater weight to valuation and individual company business fundamentals.

Market Struggling with Competing Forces

Our sense is that the market is weighing two competing forces, something we've written about in the past. On the one hand, the underlying economy appears to remain rather weak. To be sure, there have been some signs of recent improvement – better than expected home sales, a modest uptick in reported consumer spending and some narrowing of fixed income risk premiums chief among them.

But other data points still seem rather discouraging. We are concerned by the fact that consumer spending constitutes nearly two-thirds of GDP and consumers are now making a choice to spend less than they have in recent years; perhaps a lot less if they also wish to re-establish a positive saving rate. While it's difficult to put exact numbers around this idea (how much home equity was *excessively* extracted?) we don't yet hear from the companies we follow any discussion of signs that the consumer spending outlook has stabilized.

Add in a negative feedback loop, with retailers cutting inventories, manufacturers cutting production and jobs, as well as the impact of lost stock market wealth on consumer psyche, and our bet would be that penny pinching "has legs". All of this suggests that when the economy does rebound, we can count on a tailwind from inventory replenishment and perhaps some pent up durables demand, but probably not a "V" shaped turn in consumer spending of the type that has led virtually all post-war recoveries. Consumer spending will grow again, but from a new, and much lower starting point.

On the more optimistic hand, it's not as if all of this is new. Instead, it's a dynamic that has been building for at least the past year, documented daily and endlessly by the media. Valuations, as a result, are quite depressed. At the same time, the federal government is responding in unprecedented ways and to an unprecedented degree.

Of all the government initiatives, the one we'd watch most closely is the "PPIP," designed to remove troubled assets from banks' balance sheets and outlined by Secretary Geithner toward the quarter's end. To us, the issue can almost be worked backward. The market won't really turn until the economy shows signs of doing so. The economy won't turn until the consumer stops shrinking his spending. The consumer won't stop shrinking until he has confidence. He won't have confidence until he feels his job is safe and the media tells him the financial system has been stabilized, and that won't happen, at least in our opinion, until the toxic assets are off the books.

While some may argue that adding sufficient capital to the banking system is mathematically the same as removing the bad assets (and they might be right *mathematically*), we've concluded that math is not the issue. Rather it is one of simplicity and perception. We need to get to the point where a bank is able to stand up and say "all the problem assets are gone, we are well capitalized with tangible equity to assets of 6%, and our stock is selling for about tangible book value and about three times our expectation for next year's earnings."

When that happens, with enormous levels of cash sitting on the sidelines, hints of a better market will be self-propelling as investors change from fear of losing money to fear of missing a broad based and powerful rally.

Portfolio Strategy: Small- and SMID-Cap Value

In general, our deep value portfolios remain true to our contrarian roots. Approximately one-third of our Small- and SMID-Cap Value portfolios remain invested in financials, including a broad range of banks and insurance companies. Beyond financials, the portfolios retain a procyclical bias, most notably in the area of consumer discretionary names. Notably absent, as has been the case for quite some time, are meaningful holdings in either retailers or commodities, the former because we consider the world “over-stored” and the latter because we believe it is too early to play a rebound in commodities in light of the tremendous cycle which ended just six to nine months ago.

More specifically, our first quarter portfolio activity could be characterized by two main themes. First, we capitalized on the market’s weakness early in the quarter to add to existing holdings in the financial sector and to initiate new positions in several regional banks. Second, as the pullback in the market broadened, we were able to extend our research focus to areas we had not considered to be “deep-value” several months ago.

Within financials, we increased our positions in **City National (CYN)** and **Marshall & Ilsley (MI)**. Both are regional banks with strong balance sheets that are trading at a fraction of their book value. Both received TARP money from the government and, we believe, are in a very strong position to emerge from the financial crisis on a solid footing. Both positions were increased due to weakness in their respective stock prices.

We initiated new positions in three additional banks during the quarter. **Key Corp (KEY)**, **Regions (RF)** and **Washington Federal (WFSL)** are all well-capitalized banks that are trading at 30%-70% discounts to their intrinsic value. We have applied multiple stress tests to each company and believe that each stock is priced for a worst case scenario, a scenario we don’t envision. These banks are generating new pre-provision earnings that should be sufficient to offset most or all of the losses incurred over the next few years. We believe that as fear begins to subside within the banking sector and investors realize that “all banks are not created equal” these banks will revert to at least 1x their book value.

Also within financials, we exited two holdings that had quite different profiles. **IPC Holdings (IPCR)**, a reinsurer, was a successful investment that we sold for fair value. Subsequent to the end of the quarter an acquisition offer was made for the company at a price only marginally higher than what we sold for. **Syncora Holdings (SYCRF)** is a bond insurer that turned out to be an investment mistake. As a result of a complex set of negotiations with a set of its investors, it became clear to us that there would be little value left for existing shareholders and we exited our investment during the quarter. We trimmed our position in **Banco Popular (BPOP)** in an effort to manage the position sizes and aggregate sector weight of banks within our portfolio. As other banks (noted above) became as cheap as Banco Popular, we deemed it prudent to diversify our exposure and take some proceeds from Banco Popular to fund these new positions.

The stock market declines in January and February made the potential pool of deep-value investments much larger and more diverse than it was only a few months ago. As a result, we

have been able to find an increasing number of stocks outside of the financial sector that are trading at substantial discounts to their book values. During the quarter we initiated positions in **Gulf Island Fabrication (GIFI)**, a primary builder of offshore oil drilling and production platforms in the Gulf of Mexico and **Black and Decker (BDK)**, a global leader in the power tools industry, with particular strength in high end tools used by contractors.

GIFI is our first move into the now collapsed energy sector. We waited patiently while all things energy-related soared as the price of oil went well over \$100/barrel. We did not believe the profit levels were at all sustainable across the industry, and that has proven to be the case. As in past busts, investors are now overreacting the other way. Even though oil prices are down, exploration and production in the gulf is continuing. **GIFI's** revenue tends to be lumpy from year to year as big projects come and go, but the company's costs are highly variable so it can adapt to changing industry conditions. As a result, the company has never lost money in its history as a public company dating back to the mid-90s, and we expect it to remain profitable through this downturn as well. The company has no debt and is selling for about half the book value of its tangible assets.

BDK is, of course, a leading consumer name, as are other brands the company owns such as Price Pfister, Kwikset, and Baldwin. There is some linkage to residential homebuilding and remodeling, but a great deal of the revenue comes from replacement demand as power tools wear out. Even with a sharp downturn **BDK** is earning nearly \$2/share. We believe "normal" earnings exceed \$5/share. The balance sheet is in good shape. This is one of the rare opportunities to buy a well-known, good company for a very cheap price.

Portfolio Overview

| Performance | 1Q2009 | 2008 | 2007 |
|---------------------|--------|--------|--------|
| Small-Cap Value | -21.7% | -45.8% | -18.1% |
| Russell 2000® Value | -19.6 | -28.9 | -9.8 |
| SMID-Cap Value | -21.3 | -46.8 | -12.2 |
| Russell 2500™ Value | -16.3 | -32.0 | -7.3 |

Net of management fees

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

| Portfolio Characteristics | Small-Cap Value | SMID-Cap Value |
|----------------------------------|------------------------|-----------------------|
| P/E (ex. negative earnings) | 8.0x | 8.9x |
| P/B | 0.6x | 0.6x |
| Dividend Yield | 2.7% | 2.9% |
| Wtd. Avg. Market Cap. | \$1,095 mm | \$1,567 mm |
| Number of Holdings | 46 | 44 |

Disclosures

The securities discussed above were holdings during the quarter ended March 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, 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.

Value Performance Disclosures:

1. The Small-Cap Value and SMID-Cap Value 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 also include the reinvestment of all interest, realized and unrealized dividends, capital gains, capital losses and brokerage commissions computed on a trade date basis. Results 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 open and fully invested for one full month are added to the Small-Cap Value and SMID-Cap Value composites at the beginning of the following month. Composites include terminated accounts for all full months under management.
3. 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