

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 value services, the contraction is apparent when we look at price-to-normalized earnings ratios in our universe of stocks. A year ago, a stock had to be priced at less than 10x normalized earnings to be among the cheapest 20% of all stocks. Today it only takes a price of 13.7x normalized earnings for a stock to be relatively cheap.

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.

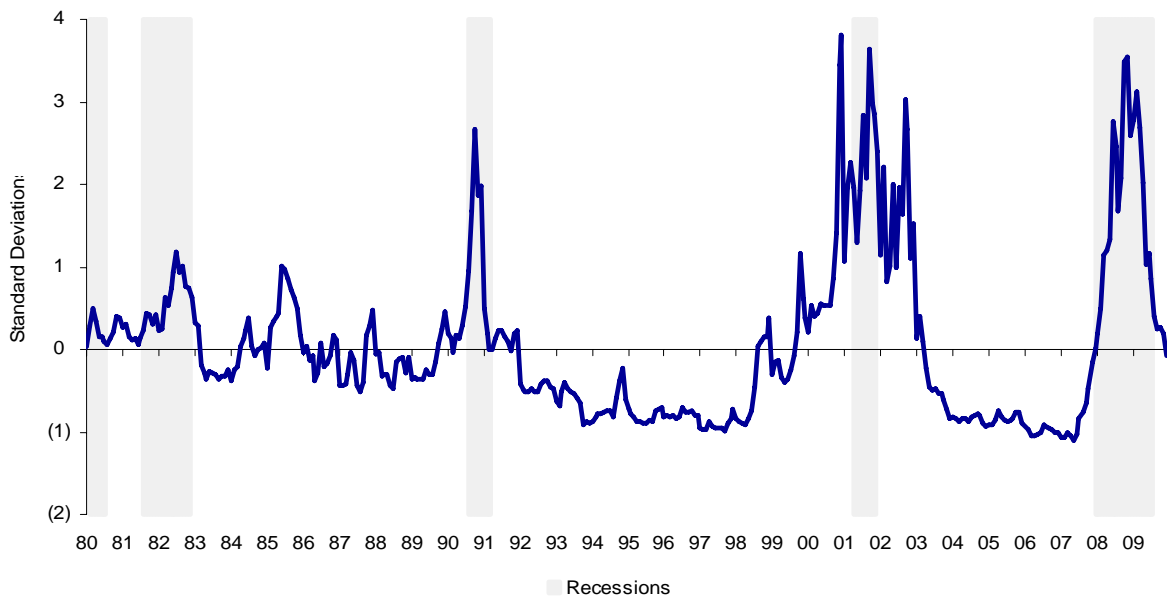
We couldn't know for certain that our estimates of the long term earnings power of these companies were correct, but we were confident that our research was thorough and thoughtful. We also knew that if we were right, our clients would be rewarded with a very large payoff. If ever there was a time to 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).

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.

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 SMID-Cap Value

As we entered the fourth quarter of 2009 we were mindful of the rapid compression of equity spreads over the prior six months. As a result, for both our Small- and SMID-Cap Value portfolios, we made the decision to let our cash levels creep up modestly and where permitted, to place some of the accumulating cash in index ETFs. We did not do this as a market timing move, but rather because some individual stocks we held over the course of 2009 had appreciated significantly, and in trimming position weights, we needed a place holder for ideas pending the completion of research. Thus as the markets remained strong during 4Q'09, we underperformed modestly. However for the full year 2009, both our Small- and SMID-Cap Value services achieved extraordinary results—up 61.5% and 50.4% net of fees respectively, several thousand basis points ahead of their relevant benchmarks*.

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

While we are conducting research in several new areas, including Healthcare, Technology, Defense and Consumer Non-durables, the portfolios exposure to Financials—both Regional Banks and Insurance remains large, in the 38% to 40% range, with about half of that in bank stocks. Financial stocks have been among our biggest winners in the past year, but during 4Q'09 it was a mixed bag. For the banks, there's no doubt that 2010 looks to be another rough year. With loan losses continuing to mount, particularly from commercial real estate, it seems unlikely that many of the banks we hold will be profitable in the year ahead.

On the other hand, the amount of loans that can go bad is finite and the yield curve is steep, meaning that pre-provision earnings are actually quite good. Moreover, we believe most of the significant capital raising is complete, thus mitigating a potential source of dilution. All in all, we don't think tangible per share book values have a lot further to fall and we are able to buy these stocks for less than the trough levels we envision. At this point, in our opinion, the return potential remains outstanding. It's just a question of time.

Insurance was also mixed during the quarter with **Assured Guaranty (AGO)** being one of our biggest winners (and one of our largest positions), offset by **MBIA (MBI)**, one of the largest detractors from performance. Assured Guaranty reported fairly good financial results for the quarter, and also solidified its credit rating with a modestly dilutive share offering. There's little rhyme or reason to the movement in MBIA's share price these days, since the stock is so beaten down that it is priced more like a call option than an equity security. In our view there was no meaningful change in the fundamentals during the quarter. One might infer from the stock price that investors grew more gloomy about the housing market or the commercial real estate market, but an equally good explanation for the move is probably that it is just noise—the stock went up for little reason in 3Q'09 and now has come back for little reason in 4Q'09. At \$4-5, it's in the same place it was 6 months ago and 12 months ago and 18 months ago, although in that time it has made multiple round trips between the high single digits and the low single digits. The outperformance of the rest of our portfolio leaves our weight in MBIA under 2% at the moment.

The other major portfolio exposure and positive contributor to returns was in the Consumer Discretionary area. Here we had several major wins—most notably **Autoliv (ALV)**, **American Axle (AXL)**, **Marine Max (HZO)** and **Black & Decker (BDK)**. Autoliv delivered earnings that were better than expected, with strong cash flow and debt reduction. The company also increased its own forecast of results for 4Q'09. We trimmed our position as the stock rallied, and used some of the proceeds to fund an investment in Lear after it emerged from bankruptcy. American Axle was once viewed as likely to follow Lear into bankruptcy, but its balance sheet has improved as a result of an equity issuance and some financial assistance from GM. The stock hit a low of \$0.26 early this year but is now at about \$9, still attractively priced relative to our estimate that the company can earn over \$0.70 in a more normal environment. MarineMax continued to liquidate inventory, reduce its debt, and shrink its footprint, making us and the market increasingly confident in its survival despite a dreadful market for boat sales. Black & Decker agreed to a merger with **Stanley Works (SWK)** at a price that was well in excess of where the stock was trading at the beginning of the quarter.

Two long time investments which we continue to own but which detracted from returns were **JAKKS Pacific (JAKK)** and **M/I Homes (MHO)**. JAKKS undertook a somewhat confusing financing deal in November. The market reacted poorly to this, but we believe the impact is not meaningful; meanwhile we were pleased that JAKKS settled some longstanding litigation in a way that was modestly favorable to the company. Although toys sold better than expected during the Christmas season, it came too late for toy suppliers who already took orders and shipped when the season was expected to be miserable. We think JAKKS can earn well in excess of \$2.50 in normal conditions, so we find it an extraordinary value at its current price around \$12. M/I Homes' stock sagged during the quarter along with most of the homebuilders but not based on anything that changed our view of the company's outlook. We believe that even if M/I had to write off 50% of the remaining land it holds—which we view as extremely unlikely—the stock would still be undervalued at its current price.

Performance & Characteristics: Small- and SMID-Cap Value

| Performance | Periods Ending 12/31/2009 | | | |
|------------------------|---------------------------|--------------|--------------|---------------|
| | MRQ | YTD | 1Year | 3Year |
| Small-Cap Value | 1.1% | 61.5% | 61.5% | -10.5% |
| Russell 2000® Value | 3.6 | 20.6 | 20.6 | -8.2 |
| Excess Return | -2.5 | 40.9 | 40.9 | -2.3 |
| SMID-Cap Value | 1.6 | 50.4 | 50.4 | -11.1 |
| Russell 2500™ Value | 4.6 | 27.7 | 27.7 | -7.0 |
| Excess Return | -3.0 | 22.7 | 22.7 | -4.1 |

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 Value | SMID-Cap Value |
|-----------------------------|-----------------|----------------|
| P/E (ex. negative earnings) | 15.9x | 15.9x |
| P/B | 1.0x | 1.0x |
| Dividend Yield | 1.2% | 1.2% |
| Wtd. Avg. Market Cap. | \$1,998 mm | \$2,928 mm |
| Number of Holdings | 40 | 42 |

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.

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 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.