

## Second Quarter 2007 Investment Update

At the close of business on June 30, assets under management had grown to just over \$500 million, the result of strong returns and cash flows into existing accounts. In addition, we opened an important new account – the Harbor Funds SMID Value mutual fund (HASMXX) – which launched on May 1. Evercore Asset Management is the sole subadvisor to this no-load fund.

Considering today's market, to value investors like us, the most noteworthy aspect is the reduction of valuation spreads to very tight levels. Stock selection in this environment is especially difficult, but critical, as the return potential for value stocks as a whole is modest; the overall universe trades at only average valuation levels relative to fundamental measures such as P/B and P/E ratios.

The causes of spread compression have been well discussed in the media: Significant liquidity, for example, and strong economic growth which is seemingly ubiquitous. Adding it all up, we live in a world with minimal controversy. With risks perceived to be low, credit has been easy.

The effect on corporate profits is impressive – we have seen five years of double-digit profit growth – which, combined with conservative capital spending has led to significant free cash flow generation and strong balance sheets. These high cash levels have motivated activism from hedge funds, which are putting pressure on corporate executives to make better use of cash or return it to shareholders. High cash levels, combined with low spreads on corporate debt, have also contributed to a record pace of M&A activity, much of it from private equity-sponsored deals.

In the aggregate, the impact has reduced the supply of public equities, and propped up many companies with questionable fundamentals, based on the prospect of private equity or hedge fund intervention. The resulting tight spreads show up in our daily work. We rank the stocks in our universe by cheapness; those ranked at the low end of the most attractive quintile now sell at 13.8x normalized earnings compared to the average stock in our universe at 16.8x, an 18% discount. Historically, this discount has been about 35%.

### *Our Philosophy*

As deep value investors, our view is that opportunities arise from emotional investors who are more concerned with market risk than business risk. We believe that near-term price movements are typically driven by hope or hype – reactions to recent news or events that are often irrelevant to a company's long-term prospects. This price volatility is largely unrelated to volatility in the cash flows of the underlying investments. And so, over time, as investors react – and often overreact – to news, a company's stock price often becomes disconnected from its underlying fundamentals. This creates opportunities for value investors. Our strict focus on the fundamentals – the operating environment, earnings and free cash flow – identifies companies whose stock prices have become cheap relative to their long-term normalized earnings power. Our portfolios consist only of companies that we believe have an outsized opportunity to appreciate in value.

All of this, obviously, will someday come to an end. Whatever the trigger – be it geopolitical, regulation or leverage, for example – real risks will become apparent. Lenders will demand higher returns, private equity will find the easy days of returns created through leverage disappear and security selection will once again drive investment returns.

In the meantime, this is a challenging backdrop for true long-term investors. While mindful of this setting, our focus remains on business fundamentals and price, and we have been able to keep pace with the market, moving our year-to-date returns well ahead of the benchmarks.

## Portfolio Overview

Performance*	2Q2007	YTD	One Year
Small Cap Value	3.29%	11.05%	14.04%
SMID-Cap Value	4.55	13.80	26.95
Partnership Value	1.97	7.48	n/a
S&P 500	6.28	6.96	20.59
Russell 2000®	4.42	6.45	16.43

\*Periods ending June 30, 2007; Net of fees

Material developments related to our portfolio holdings this quarter centered around Lear Corp., which announced that it would delay the vote on the buyout offer from Carl Icahn; Chittenden Corp., which agreed to be bought at a 31% premium; and W Holding Co., which announced that one of its larger asset-based loans is impaired.

### Lear Corporation – LEA

Toward the end of June three shareholder advisory services, Glass Lewis, Proxy Governance Inc. and Institutional Shareholder Services (ISS) recommended that shareholders vote against the Carl Ichan-controlled American Real Estate Partners LP (AREP) takeover offer. As ISS has said, the offer price was not high enough due to better-than-expected results. Indeed earnings are improving. LEA announced just prior to these recommendations that it had raised its financial outlook citing better-than-expected production levels of light trucks and the benefits of its ongoing restructuring. Also, LEA has considerable market share, a growing position in Asia, and its auto seating parts business has been strong despite an industry slowdown. LEA delayed the previously scheduled June 27 vote by two weeks so it could “set the record straight” and correct the “misinformation about what motivated the transaction.” This is in reference to the potential conflicts of interest of Lear’s CEO and his concerns over his deferred compensation, including retirement benefits and equity interests. Following the close of the quarter, AREP raised its offer by 2.8% to \$37.25 per share but our position remained that the business is grossly undervalued. On July 16 Lear announced that shareholders rejected the AREP offer.

## Chittenden Corp. – CHZ

Chittenden Corp., a bank holding company based in Vermont, agreed to a purchase offer by Connecticut-based People's United Financial. The purchase price represents a 31% premium to CHZ's June 26 closing share price. Our investment thesis was based on an expectation for Chittenden's net interest margins to improve from levels that are currently depressed by rising deposit costs and a flat yield curve, but we were also aware of the bank's attractiveness as a buy-out candidate. CHZ has historically operated as a highly profitable commercially oriented bank with a low-cost core deposit franchise and a conservative credit history, making it a desirable target for larger competitors looking to expand in the slow-growth New England market. The boards of both companies have approved the deal and expect it to close in the first quarter of next year, pending shareholder approvals.

## W Holding Co. Inc. – WHI

WHI is a bank holding company in Puerto Rico. The economy there has been weak for some time, which is why the stock is cheap. The company announced that it may have to write down a large asset-backed loan, estimating collateral deficiency of \$80 million. The loss is surprisingly large, implying either the loan was very large compared to their average loan, or that the loan was far too under-collateralized. WHI's normal practice is for any loan larger than \$50 million to go before the board for approval. There are some indications that that may not have happened in this case. The board has hired an outside firm to examine the entire loan portfolio and review internal controls. The stock was down 35% – not so much because of this one loan, which would only amount to a loss of approximately 30c/share, but because investors fear that there are more problem loans lurking in the portfolio. We share this concern; one of the fundamental challenges in valuing banks is that we never know as much as we would like to know about the quality of the loan portfolio. In lieu of being able to examine the individual loans in the portfolio, we look at general characteristics of the portfolio – what type of loans are they, the size they tend to be, how much collateral is normally put up, for example. We also look at historical loan losses, provisions for loan losses and related metrics of credit quality. We continue to watch WHI very closely.

## Portfolio Characteristics

	Small-Cap Value	SMID-Cap Value	Partnership Value
P/E (ex. negative earnings)	18.8x	16.3x	19.0x
P/B	1.6x	1.8x	1.6x
Dividend Yield	1.3%	1.9%	1.3%
Wtd. Avg. Market Cap. (mm)	\$1,168	\$3,470	\$1,723

Disclosures:

- 1. The Small-Cap Value, SMID-Cap Value and Partnership Value composites comprise discretionary accounts with no material investment restrictions. Net of fee performance results reflect the deduction of advisory fees and brokerage commissions. The results also include the reinvestment of all interest, dividends and capital gains and were computed on a trade date (as opposed to settlement date) basis. Accounts that are open and fully invested for one full month are added to the composite at the beginning of the following month. Weighted performance measures the average performance of all portfolios in the composite weighted by size. The performance returns reflect the deduction of fees according to the applicable investment advisory fee schedule. Performance results for individual accounts vary due to the timing of investments, additions/withdrawals, length of relationship, fee schedule and size of positions, among other reasons. Past performance is no guarantee of future results. 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.*
- 2. The securities discussed above were holdings during the quarter ended June 30, 2007. 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.*
- 3. The clients noted above represent newly acquired accounts during the quarter which have given us permission to disclose the use of their name and the investment mandate.*
- 4. All information provided in this presentation is for informational purposes only and should not be deemed as a recommendation to buy or sell the securities mentioned. We believe this is a balanced presentation of the performance of the portfolio, including a general summary of certain investments effected by the services that have both over and under performed the expectations of our portfolio managers. Past performance is not necessarily indicative of future results. Evercore Asset Management closely monitors the securities held in the portfolios. If a company's underlying fundamentals or valuation measures change, Evercore Asset Management will reevaluate its position and may sell part or all of its holdings.*