

Third Quarter 2009 Investment Update

More than anything else the third quarter of 2009 was marked by a feeling that the worst had passed. Industrial America might not be booming, but earnings seemed to have bottomed. The credit markets might not be free flowing, but rates fell steadily and access to the markets improved. The unemployment rate remains high, but the pace of new layoffs eased. Hardly the ingredients for euphoria, but against the base case in early 2009 of a pending economic doomsday, simply believing that the worst had passed was enough to send stocks soaring, rewarding those who took the contrarian position and remained committed to their investment processes.

As a result, thus far 2009 has been a good year for our clients. With gains in the third quarter adding to those realized earlier in the year, our Small-Cap Value and SMID-Cap Value services have appreciated (net of fees) 60% and 48% respectively year to date.*

On the back of such a rebound, we are often asked whether there is much left to go. Our best estimate is that we are approximately 75% through the rebound, with valuation spreads having contracted from about four standard deviations above normal to something closer to one standard deviation above normal today.

Thus far, however, the improvement has been fairly quick and forceful, largely, we believe, a function of increasing P/E ratios produced from a realization that some of the worst case scenarios seem to have been taken off the table. Going forward, we would look for a more graceful and tempered trend driven by actual earnings improvements and, in the case of financial stocks, a clear leveling off of bad loan reserve additions.

Moreover, we wouldn't be surprised to see a period where performance goes sideways or at some point we experience a temporary retrenchment. After all, it's not as if the current economic underpinnings are all that solid. In particular the employment outlook remains worrisome (which should act as a deterrent against any sharp rebound in consumer spending, the source of most previous recoveries) as does the potential for companies to continue to recapitalize themselves through dilutive equity offerings as they seek to insulate themselves from a repeat of the trauma of the past two years.

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

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.

On the other hand, as the economic recovery progresses, we also wouldn't be surprised to see valuation spreads that eventually contract to a point well below average. If nothing else, investors have repeatedly demonstrated a tendency to put events behind them on the theory that all is well and history is unlikely to repeat itself.

As we reflect on the drama of the past 18 months, we have been considering whether any lessons can be learned from the way this cycle has played out thus far—staying mindful of the pitfalls of attempting to learn too much.

Setting aside some of the obvious ones (e.g., beware the financial instrument that is hard to explain) and some things better left to Washington (e.g., financial services industry regulation), at least three come to mind.

First, fundamental research mattered more in this cycle than at any point we can remember in the past twenty five years. At the mid-winter nadir, many investors were envisioning near apocalypse. Entire industries (most notably banking) were declared beyond resuscitation. Seizing the investment opportunity, therefore, required a tremendous amount of courage and confidence in one's research. For those that did the research, it was the resulting confidence that allowed them to stick to their discipline and even add to their positions during the gloomiest moments. More often than not, a failure to do this leads one to suffer on the way down, capitulate at the bottom and miss the reward on the way up. It is a formula for systematic underperformance.

Second, for the inherently fundamental manager, the use of quantitative tools should be limited to initial idea generation rather than risk reduction, whether relative or absolute. For the third cycle in a row (1990-1991, 1999-2000 and the current one), such models have failed to protect investors and have even, arguably, exacerbated poor performance. In part, we suspect this is because they fail to understand newly emerging correlations, a testament to the fact that each cycle is unique. In part, we think these models have a hard time understanding leverage or, put another way, distinguishing between the market's perception of equity value and the market's perception of enterprise value. It's difficult to have much faith in buying a collection of attractively priced stocks if the book value is subject to evaporation because it is conjoined with a mountain of debt.

Third, the impact on the markets of human emotion is alive and well, perhaps even increasing in significance. We see the advent of new investment vehicles such as ETF's, as a problematic development especially when combined with the tendency of many investors to be backward looking. Theoretically these vehicles are acting to democratize the market by allowing investors a low cost way to make a diversified bet on a particular sector or segment of the market. As a practical matter, however, they seem to be adding to volatility as investors pile in from one sector to the next seeking to ride waves of market momentum. The surge in energy-related stocks in the second quarter of 2008 is perhaps the best recent example. Our bet is that the market has become permanently more volatile, in part, as a result of this tool.

Finally, investors should be careful about taking any of the lessons learned too seriously. Wall Street has a knack for never losing the same war twice. Unfortunately, the same war is never fought twice. Each cycle brings with it its own unique set of facts, twists and turns. When all is said and done, we think most investors would be best served by choosing a strategy and then sticking to it by hiring a collection of managers that are unique, committed, articulate and drift-proof. Once done, don't try to add value by over-managing the collection along the way.

Below we discuss the current positioning of our Value services.

Portfolio Strategy: Small- and SMID-Cap Value

During the second quarter of 2009 our Small- and SMID-Cap Value portfolios achieved exceptionally strong returns as valuation discounts swiftly contracted from their March 9th highs. Entering the third quarter of 2009, we believed the near-term alpha potential of our services remained high, although we expected returns to continue to accrue in a less dramatic fashion than they had in the prior quarter. It seems our cautious market view proved to be a bit premature, as the third quarter continued to be a period of extraordinary returns. With small-cap stocks outperforming large-cap stocks, and, within small-cap, value besting growth, it's not surprising that we meaningfully outperformed our benchmarks. Both of our value services achieved returns for the quarter of more than 35% (net of fees)—close to 1,300 to 1,400 basis points ahead of the Russell 2000 Value and the Russell 2500 Value Indices.*

The biggest contributors to these returns came from our holdings in sectors that many considered the most controversial—Consumer Discretionary and Financial Services—areas which for some time have been rich in opportunity for value investors. Our investments in these areas were leading detractors from returns during much of 2008 and early 2009 as investor panic took hold. While it was an uncomfortable period for us, we continued to rely on our research and lean into the cycle, adding to positions where we had the greatest confidence, thereby lowering the portfolio's average cost. This approach was an important contributor to the positive results we achieved for the quarter.

The leading contributors within Consumer Discretionary were **MarineMax (HZO)**, a boat retailer), **Dollar Thrifty Automotive (DTG)**, **American Axle (AXL)**, and two homebuilders—**M/I Homes (MHO)** and **Standard Pacific (SPF)**. We have written about DTG several times over the past few quarters. The recovery in DTG's business and the market's dramatic response during the second quarter of 2009 continued in the third quarter. We trimmed this outsized position throughout the quarter and ultimately made a complete exit as the stock reached our fair value target.

Two major auto parts suppliers, American Axle and **Lear (LEA)**, have been investments in our portfolio for some time. We maintained both positions throughout the downturn as we felt that even with a large dilutive equity offering for either company they would still trade significantly below fair value. On the positive side, AXL proactively approached its bank group to negotiate more headroom in their covenants, which they successfully completed during the height of the

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financial crisis. Additionally, insiders at AXL continued to make significant share purchases and to reiterate a desire to maintain equity shareholder value. We purchased more stock and meaningfully lowered the position's average cost in our portfolios. Lear's management team on the other hand seemed overly confident in the company's financial position and moved very slowly to acknowledge their problems. We did maintain a small position in the portfolio, which ultimately turned out to be a disappointment as, by the time Lear's management team acknowledged their balance sheet issues, their solution—a pre-packaged bankruptcy—was clearly not in the equity holders' favor.

M/I Homes and Standard Pacific performed well as signs emerged of a bottom in the housing market and the companies' balance sheets improved. In both cases, we added to our holdings when the stocks were far below our initial purchase prices, thereby turning what seemed to be disappointing investment outcomes into relative outperformers over our holding period. We still view both companies as very attractive and expect meaningful upside from current levels.

Our portfolio strategy with regard to Financial Services remains intact. We continue to hold an approximate weight of 35% in the sector. That's about in line with the benchmark, but our exposures are focused specifically on regional banks and certain insurance companies. What our banks and insurance companies have in common is that both types of companies are incurring losses related in one way or another to the real estate markets. During the quarter, we continued to add to and diversify our regional bank holdings, and several of them—most notably **Regions Financial (RF)** and **Marshall & Ilsley (MI)**—were important contributors to performance as investors began to see early signs that the rate of loan write-downs may begin to decline and the likelihood of dilutive equity issuance subsided. Our Insurance holdings were also big contributors, most notably **Assured Guaranty (AGO)** and **MBIA (MBI)**, which will also be beneficiaries of any improvement in the housing market. Assured Guaranty also reported strong operating results and an improving balance sheet for the quarter, as did another of our insurers, **XL Capital (XL)**.

Portfolio Overview

Periods Ending 9/30/2009

Performance	MRQ	YTD	1Year	3Year
Small-Cap Value	35.3%	59.8%	9.1%	-8.2%
Russell 2000® Value	22.7	16.4	-12.6	-6.6
Excess Return	12.6	43.4	21.7	-1.6
SMID-Cap Value	36.7	48.0	4.3	-9.2
Russell 2500™ Value	22.8	22.0	-8.3	-5.7
Excess Return	13.9	26.0	12.6	-3.5

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)	15.2x	13.8x
P/B	0.9x	0.9x
Dividend Yield	1.1%	1.2%
Wtd. Avg. Market Cap.	\$1,992 mm	\$3,021 mm
Number of Holdings	36	39

Source: Evercore Asset Management and BNY Mellon Asset Servicing

Disclosures

The securities discussed above were holdings during the quarter ended September 30, 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.