LargeCap Strategy

ADVANCED INVESTMENT PARTNERS

Q1 2010 INVESTMENT UPDATE

Market Overview

US Equities

During the first quarter of 2010, the US equity market continued the powerful rally which began on March 9, 2009. This is despite a rising chorus of naysayers proclaiming the rally to be overextended. After all, a 75% rally can't go any further, can it? We'd do well to remember the words of Sir John Templeton: "Bull markets are born on pessimism, grown on skepticism, mature on optimism, and die on euphoria. The time of maximum pessimism is the best time to buy and the time of maximum optimism is the best time to sell."

As during December 2009, higher-risk stocks led the rally during the first quarter. Smaller stocks consistently outperformed larger stocks, and performance improved as one slid down the cap scale. The small cap **Russell 2000® Index** advanced 8.9% during the quarter, and has recorded a 12-month gain of nearly 63%. The **Russell Midcap 800® Index** gained 8.7% for the quarter, and the large-cap **Russell 1000® Index** added 5.7%. Finally, the generals brought up the rear - the mega-cap **Russell Top 200® Index** tacked on a still-impressive 4.6%.

Value stocks are often considered to be riskier investment plays. With investors back in risk-seeking mode, value stocks outperformed their growth counterparts across the market. The best-performing style group was small-cap value; the **Russell 2000® Value Index** leapt 10.0%. The worst-performing style group was mega-cap growth stocks; the **Russell Top 200® Growth Index** advanced 3.5% nonetheless.

Further evidence of risk seeking can be seen in the various sector returns of the Russell 1000 Index. The typically more stable **Telecom** and **Utilities** sectors were the laggards, shedding 3.5% and 3.0%, respectively. **Industrial** stocks paced the market's advance, climbing 12.4%. The **Financial** sector was next-best, tacking on 11.4%.

Portfolio Review

Our large cap strategy was solidly ahead of the **S&P 500®** during the first quarter of 2010, with stock selection – driven by our models - proving to be the primary source of value-added. A modest overweight in the **Technology** sector and a modest tilt towards smaller members of the S&P 500 Index were also positive contributors. New positions which performed best during the quarter include aerospace material maker **Titanium Metals** (TIE), computer chipmaker **Advanced Micro Devices** (AMD), and realty trust **Vornado Realty** (VNO). TIE has topped the S&P 500 by nearly 35% since being added to the portfolio on February 23rd; AMD and VNO have topped the index by 12.2% and 8.1%, respectively, since purchase.

Underweights to the **Health Care** and **Consumer Discretionary** sector detracted from active performance. A few new positions in the portfolio did not perform to our expectations in the short run. Two purchases in the Energy sector have struggled to date: **Plains Exploration and Production** (PXP) and **EOG Resources** (EOG) have trailed the S&P 500 by 11.7% and 7.8%, respectively, since our recent purchase.

Investment Team

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Firm Overview

- A pioneer in advanced quantitative investment strategies
- Founded in 1996
- Principals own meaningful equity stake
- Manages the following strategies for clients in the US and Europe:

  - MaxCap
  - MaxCap Value
  - LargeCap
  - Sustainable Responsible LargeCap
  - AllCap
  - TaxManaged AllCap
  - TaxManaged LargeCap
  - SMidCap

Portfolio Changes

We moved from an underweight to an overweight and increased the portfolio's exposure to the Services sector by 6.3% during the first quarter, primarily by adding to existing positions in **AT&T** (T) and **Equifax** (EFX). The portfolio now has a near four percent overweight in that sector. We also added nearly 4% to our holdings in the Technology sector and are now about 2.1% overweight. Here, we opened a significant position in **Apple** (AAPL) and added to positions in **Advanced Micro Devices** (AMD) and **National Semiconductor** (NSM).

We trimmed the portfolio's exposure to the **Consumer Staples** sector by nearly 5% during the past quarter. Here, we sold our positions in tobacco producers **Reynolds American** (RAI) and **Philip Morris** (PM). We also reduced our exposure to the Financial sector by liquidating **JP Morgan** (JPM), **US Bank** (USB), and trimming our position in **Wells Fargo** (WFC).

Recent Transactions

As a reminder, our quantitative portfolio management process places emphasis on the construction of an entire portfolio, seeking to maintain a risk profile very similar to that of our S&P 500 benchmark. Stocks are included in the portfolio not only for their expected return, but also for their contribution to the portfolio's risk profile.

Top Active Weights - 3/31/10	
Top Five Overweights vs. S&P 500	**Portfolio**
General Dynamics	2.75%
eBay	2.56
Procter & Gamble	2.32
Abbott Laboratories	2.28
ConocoPhillips	2.25
Top Five Underweights vs. S&P 500	**Portfolio**
General Electric	-1.86%
Bank of America	-1.70
JP Morgan Chase	-1.70
Cisco Systems	-1.44
Pfizer	-1.31

Purchases

Advanced Micro Devices (AMD) provides processing solutions for the computing and graphics markets in the United States, Canada, Europe, and Asia. It offers microprocessor products, embedded processor products, chipset products, and graphics products. The company serves original equipment manufacturers, original design manufacturers, and third-party distributors through direct sales force and independent sales representatives. AMD scored very well according to our models, particularly with respect to its high return on capital. Additionally, with the market rewarding stocks which had trailed the market over the prior year, AMD's relatively poor price momentum was a favorable component of the forecast.

	Portfolio Weight	S&P 500 Weight
Consumer Discretionary	6.32%	5.81%
Consumer Staples	9.75	10.22
Energy	11.47	9.77
Financials	18.49	17.58
Health Care	10.37	11.93
Industrials	6.42	7.55
Materials	3.93	5.01
Retail	1.81	5.45
Services	8.84	5.22
Technology	20.02	17.94
Utilities	2.58	3.52

National Semiconductor (NSM) designs, develops, manufactures, and markets analog and mixed-signal integrated circuits and sub-systems. National Semi looked attractive relative not only to its sector and style peers, but to all other large cap stocks. The company has solid earnings quality, and its trading pattern was particularly attractive at our point of entry.

Robert Half International (RHI) provides staffing and risk consulting services in North America, South America, Europe, Asia, and Australia. We rated RHI as particularly attractive relative to its Services sector peers. As with AMD, the market's changing leadership pattern led us to an attractive forecast for RHI. The market has also been disregarding P/E ratios, and so RHI's high P/E did not hurt the return forecast.

Sales

Freeport McMoran Gold (FCX) engages in the exploration, mining, and production of mineral resources. It primarily explores for copper, gold, molybdenum, silver, and cobalt deposits. The company holds interests in various properties located in North and South America; Grasberg minerals district in Indonesia; and Tenke Fungurume minerals district in the Democratic Republic of Congo. FCX outperformed the S&P 500 benchmark by over 127% during our holding period. Despite FCX's very strong return on capital, the market's current preference for smaller stocks with relatively low earnings yield resulted in a weaker return forecast.

Occidental Petroleum (OXY) operates as an oil and gas exploration and production company primarily in the United States. The company operates in three segments: Oil and Gas; Chemical; and Midstream, Marketing, and Other. OXY had become relatively unattractive relative to its sector and style peers. The company outperformed the S&P 500 Index by nearly 4% during our holding period.

Unum Group (UNM) provides group and individual disability insurance products primarily in the United States and the United Kingdom. The company also provides a portfolio of other insurance products, including long-term care insurance, life insurance, employer and employee-paid group benefits, and related services. UNM trailed the S&P 500 Index by nearly 7% during our holding period. This stock traded poorly in large part due to the market's healthy appetite for riskier shares.

Market Outlook

The bond market appears to be nearing the end of – or have already ended - a historic cyclical run. Credit spreads have collapsed from deep crisis levels to more normal levels. Treasury yields can't really go much lower. Ten year yields appear to have bottomed – which would be a cyclical bottom. Much more important to investors should be the fact that long government bonds may have hit the end of a secular bull run as well. The massive health care package recently passed will likely add to the government's massive debt burden. (The government's debt problem, of course, is really your, mine and our children's debt problem). While increased long-term rates correspond to an increase in the discount rate used in valuing equities, and thus acts as a damper on equity returns, the end of the bull market in Treasuries may also lead to outflows from fixed income and inflows into equities.

We believe that with volatility and credit spreads collapsing, estimated earnings growth slowing later this year, and stock correlation on the decline, we are returning to an environment more conducive to active management. Further, our models are indicating a preference to higher quality stocks (lower earnings variability, lower beta, higher dividend yield). We look forward to a steady crawl back to normalcy – even if it's "new normalcy".

Disclosure

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