

MaxCap Value Strategy

Q3 2009 INVESTMENT UPDATE



ADVANCED INVESTMENT PARTNERS

Market Overview

US Equities

The third quarter of 2009 saw a continuation of the “low-quality” rally which began on March 10th, albeit in slightly less extreme fashion. As the dollar weakens on the back of “quantitative easing” (i.e., a ramped-up printing press) and massive projected budget deficits, everything priced in greenbacks is reflating. Count stocks among the beneficiaries.

As discussed last quarter, the increased risk appetite of equity buyers manifests itself in many ways, including a preference for more volatile stocks. To wit, mid-cap stocks outperformed all capitalization groups, the Russell Midcap® 800 Index advancing 20.6%. This group was followed closely by small-cap stocks, the Russell 2000® Index leaping 19.3%. Mega-cap stocks trailed by a sizeable gap, albeit the Russell Top 200® Index recording a hefty 14.4% return for the third quarter.

In the same vein, value stocks outperformed growth stocks by a wide margin across the entire market capitalization spectrum. Value outperformance is typical as the economy shows signs of reaching the end of a recession, as investors alter their mindset toward “a rising tide lifts all boats”. The absolute best performing style group was the **Russell MidCap® Value Index**, which soared 23.6% during the quarter. Next best was the **Russell 2000® Value Index**, which climbed 22.7%. As during the second quarter, the worst performing style index was the **Russell Top 200® Growth Index** (still up 12.7%), with the **Russell 2000® Growth Index** next worst (up 16.0% for the quarter).

The **Materials** sector continued to be the best performing sector in the Russell Top 200 Value Index, and after Q3’s 32.4% advance, the sector is up 58.8% year-to-date. The **Industrials** sector was the next-best performing sector, gaining 28.4% during this quarter. The sector has erased all losses incurred during the first quarter of the year. **Financials** returned an impressive 25.4% as well. **Utilities** and **Telecommunications** sectors fared worst, albeit adding 3.8% and 5.4%, respectively, during the quarter.

Portfolio Review

In the 3rd quarter, the portfolio’s performance lagged the Russell Top 200 Value Index’s. However, there were several portfolio exposures which boosted performance. Such exposures include a residual underweight to the Utilities sector and residual overweights to the Consumer Durables and Consumer Staples sectors. Varying exposure to the Financials sector and a portfolio tilt towards lower than average market capitalization stocks improved active performance. New purchases which performed quite well during the quarter include positions in financial services giant **Bank of America** (BAC), retail concern **Gap** (GPS) and investment manager **BlackRock** (BLK). Bank of America outperformed the Russell Top 200 Value Index by 18.1% since our initial purchase on July 7th. Gap and Blackrock have beaten the index by 8.9% and 5.9%, respectively, since their initial purchase.

A residual overweight to the Health Care sector, pure stock selection and the portfolio’s tilt towards stocks with higher-than-average intermediate term price momentum hurt active performance. Several new purchases made during the

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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

quarter did not meet our expectation. Those purchases include health insurance provider **Aetna** (AET), and energy concern **XTO Energy** (XTO). Aetna trailed the Russell Top 200 Value Index by 13.9% since our purchase on July 7th, while XTO Energy trailed the Index by 7.9% since our August 4th purchase.

Portfolio Changes

We increased the portfolio's exposure to Consumer Staples by 2.6% via an addition to the existing position in **Reynolds American** (RAI). The portfolio has a residual overweight to the Consumer Staples sector. The portfolio's exposure to the Retail sector increased by 2.5% via a new position in **Gap** (GPS) and an addition to the position in **Lowes** (LOW). The portfolio now has a significant overweight to the Retail sector.

We trimmed the portfolio's exposure to the Materials and Industrials sectors by 2.4% and 5.5%, respectively, in large part by liquidating positions in **FedEx** (FDX), **Northrop Grumman** (NOC), **United States Steel** (X) and trimming positions in **Norfolk Southern** (NSC) and **Exxon Mobil** (XOM). The portfolio is now underweight to both the Materials and Industrials sectors.

Top Active Weights - 09/30/09

Top Five Overweights vs.

Russell Top 200 Value	Portfolio
State Street	2.78%
Franklin Resources	2.74
Travelers Companies	2.72
Viacom	2.64
General Dynamics	2.51

Top Five Underweights vs.

Russell Top 200 Value	Portfolio
General Electric	-2.31%
Bank of America	-2.30
Verizon	-2.29
Goldman Sachs	-2.28
Occidental Petroleum	-1.68

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 Russell Top 200 Value benchmark. Stocks are included in the portfolio not only for their expected return, but also for their contribution to the portfolio's risk profile.

Purchases

BlackRock (BLK) is a publicly owned investment manager. The firm manages separate client-focused equity, fixed income, and balanced portfolios, open-end and closed-end funds. It invests in the public equity, fixed income, real estate, and alternative markets across the globe. The firm employs a fundamental analysis with a bottom-up approach to make its portfolio for investments. It employs liquidity, asset allocation, balanced, real estate, and alternative strategies to make its investments. BlackRock was founded in 1988 and is based in New York, New York. Our models indicated favorable trading patterns for the stock, and we purchased BlackRock on September 1st. The stock has outperformed the Russell Top 200 Value Index by 5.9% since that time.

	Portfolio	Russell Top 200 Value
	Weight	Weight
Consumer Discretionary	11.03%	6.45%
Consumer Staples	4.67	4.64
Energy	20.16	20.35
Financials	26.26	25.45
Health Care	14.31	11.25
Industrials	6.72	7.71
Materials	1.65	4.67
Retail	5.66	2.45
Services	5.13	7.10
Technology	4.41	4.75
Utilities	0.00	5.09

Walt Disney (DIS) operates as a diversified entertainment company worldwide. The company has domestic broadcast television network, television production and distribution operations, domestic television stations, cable/satellite networks, etc. It also produces, licenses, and distributes cable and animated television programming. The company owns and operates the Walt Disney World Resort in Florida that includes theme parks, hotels, vacation ownership units, etc. Walt Disney was founded in 1923 and is based in Burbank, California. We purchased Disney's stock on July 7th; the stock has outperformed the Russell Top 200 Value benchmark by 0.6% since its initial purchase.

Cardinal Health (CAH) provides health care products and services primarily in the United States. The company distributes branded, private-label medical and

laboratory, generic pharmaceutical, healthcare, and consumer products to retail customers, hospitals, and alternate care providers. The company was founded in 1979 and is headquartered in Dublin, Ohio. Our models rated CAH a strong buy as the stock sported attractive returns on capital as well as moderate book value relative to price.

Sells

Amgen (AMGN) engages in the discovery, development, manufacture, and marketing of human therapeutics based on advances in cellular and molecular biology. The company markets human therapeutic products primarily in the areas of supportive cancer care, nephrology, and inflammation. AMGN performed much better than the Russell Top 200 value benchmark during our holding period, topping the index by 33.1%. Despite solid return on capital figures, Amgen's intermediate-term price momentum made the stock score poorly. We exited the position on July 7th.

FedEx (FDX) provides transportation, e-commerce, and business services in the United States and internationally. The company was founded in 1971 and is headquartered in Memphis, Tennessee. We exited the position in FedEx on September 11th based on deteriorating return on capital and a poor trading pattern. During the holding period, the stock has beaten the benchmark by 2.8%.

WellPoint (WLP) operates as a commercial health benefits company in the United States. It also provides various managed care services comprising claims processing, underwriting, stop loss insurance, actuarial services, etc. The company was formerly known as

Anthem, Inc. and changed its name to WellPoint, Inc. in November 2004. WellPoint was founded in 1944 and is based in Indianapolis, Indiana. Our models indicated greater probability of negative earnings surprise and unattractive technical trading patterns. We exited the position on August 18th; the stock's performance lagged the benchmark index's by 5.6% during the holding period.

Market Outlook

Let's take a moment to stand on the shoulders of giants and look ahead. Firstly, in an article penned for the Wall Street Journal, James Grant (editor of Grant's Interest Rate Observer) notes, "the deeper the slump, the zippier the recovery", and that there are no exceptions to this rule. Further, he cites English economist Arthur C. Pigou's observation that "the error of optimism dies in the crisis, but in dying gives birth to an error of pessimism. This new error is born not an infant, but a giant."

I often conclude our quarterly commentary with a reminder of the tenets of our investment methodology, including discipline, objectivity, and adaptability. Grant himself invokes the words of an investing giant (Henry Singleton, longtime CEO of Teledyne, whom Warren Buffet described as the best allocator of capital):

"I know a lot of people have very strong and definite plans that they've worked out on all kinds of things, but we're subject to a tremendous number of outside influences and the vast majority of them cannot be predicted. So my idea is to stay flexible." Count on us to emulate this.

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Investors cannot invest directly in an index. These indexes are not managed or sold by Advanced Investment Partners.

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