MaxCap Value Strategy

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 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 Top 200® Value Index**. The typically more stable **Utilities** and **Telecom** sectors were the laggards, shedding 3.8% and 5.5%, respectively. **Industrial** stocks paced the market's advance, climbing 16.9%. The **Consumer Discretionary** sector was next-best, tacking on 12.1%.

Portfolio Review

The portfolio's performance was solid in the first quarter, topping the Russell Top 200 Value Index' performance by 1.8%. Performance was largely driven by excellent stock selection and was also lifted by positive exposure to the Consumer Discretionary sector and a slight underweight towards the Utilities sector. Successful new positions in **Comcast** (CMCSA) and **Prudential Financial** (PRU) outpaced the benchmark by 11.8% and 13.1%, respectively, after our purchase within the quarter.

The portfolio's tilt towards stocks with higher-than-average earnings yield, an overweight to the **Energy** sector, and lower-than-average dividend yield all detracted from active performance. New positions which did not meet expectations during the quarter included **Public Service Enterprise Group** (PEG) underperforming by 9.5%, and **Schlumberger** (SLB) which trailed the index by 8.8%.

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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 continued to increase the portfolio's exposure to Energy and Technology while also adding to Utilities. This increased the overweight in Energy to a near maximum overweight and moved Utilities from a max underweight to a moderate underweight. **Technology** continues to be a moderate overweight. In the Energy sector we initiated positions in **Schlumberger** (SLB) and added to the position in **Hess** (HES). Within Utilities, we initiated a new position in included **Public Service Enterprise Group** (PEG).

We continued to trim the portfolio's exposure to the **Health Care** sector, and also trimmed our **Financials** allocation by 2.7%. In Health Care, we fully liquidated our successful position in **UnitedHeath Group** (UNH) and trimmed the position in **Cardinal Health** (CAH). This positions the portfolio with a moderate underweight to Health Care. In Financials, we liquidated the holding in **State Street** (STT), and trimmed positions in **Capital One** (COF), **JP Morgan** (JPM), and **Franklin Resources** (BEN).

Top Active Weights - 12/31/09

Top Five Overweights vs. Russell Top 200 Value	Portfolio
Aetna	2.71%
Wells Fargo	2.70
Williams Companies	2.65
Travelers	2.64
General Dynamics	2.58

Top Five Underweights vs. Russell Top 200 Value	Portfolio
Bank of America	-2.94%
Verizon	-2.12
Pfizer	-2.07
Goldman Sachs	-2.01
Citigroup	-2.00

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

Comcast (CMCSA) provides consumer entertainment, information, and communication products and services to the residential and commercial customers in the United States. The company operates in two segments, Cable and Programming. We purchased CMCSA due to an attractive earnings quality and strong return on capital.

	Portfolio Weight	Russell Top 200 Value Weight
Consumer Discretionary	10.87%	7.28%
Consumer Staples	1.74	4.58
Energy	24.07	19.33
Financials	28.75	26.97
Health Care	8.45	10.75
Industrials	4.48	7.91
Materials	1.78	4.57
Retail	7.28	2.60
Services	3.99	6.40
Technology	7.78	5.00
Utilities	0.81	4.61

Schlumberger Ltd (SLB) supplies technology, integrated project management, and information solutions to the oil and gas industry worldwide. The company operates in two segments, Oilfield Services and WesternGeco. SLB's forecast showed the potential for an earnings surprise coupled with an improving trading pattern.

Prudential Financial (PRU) provides various financial products and services in the United States, Asia, Europe, and Latin America. The company operates through three divisions: The U.S. Retirement Solutions and Investment Management, The U.S. Individual Life and Group Insurance, and The International Insurance and Investments. Our models scored PRU as attractive based on high earnings quality and strong return on capital.

Sales

UnitedHealth (UNH) provides healthcare services in the United States. It provides health and well-being services for individuals aged 50 and older, as well as to large national employers, public sector employers, mid-sized employers, small businesses, and individuals; health insurance products and services; and network-based health and well-being services to beneficiaries and other government-sponsored health care programs. We sold the position due to decreasing earnings forecasts, the position having outperformed by 18.7% over our holding period.

State Street (STT) provides various products and services for institutional investors worldwide. The company serves mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations, endowments, and investment managers. STT was sold after outpacing the benchmark by 5.8% over our holding period. STT was in a weak trading pattern with a moderating earnings forecast.

Viacom (VIA.B) operates as an entertainment content company primarily in the United States and Europe. It operates in two segments, Media Networks and Filmed Entertainment. VIA.B bested the index by 36% over our holding period. The position was sold due to a trading pattern indicating the stock was overbought and decreasing earnings forecasts.

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

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