

SMidCap 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).

As during the second quarter, the best performing sector within the Russell 2500™ Index was **Energy**, tacking on a 28.6% gain, to bring its year-to-date return to 48.1%. Year-to-date, **Energy** trails only **Consumer Discretionary** (53.0%) and **Information Technology** (51.3%). Investors’ inclination to bear higher portfolio risk is evidenced by **Telecom Services** and **Utilities** lagging performance; still, these sectors added 7.1% and 10.1%, respectively, during the third quarter.

Portfolio Review

The SMidCap strategy narrowly trailed the Russell 2500™ Index during the third quarter, despite a positive contribution from individual stock selection. Active performance was also boosted by overweighting the Consumer Cyclical sector and underweighting the Health Care sector. Top-performing additions to the portfolio include electronic equipment manufacturer **Jabil Circuit** (JBL), oil and gas concern **Stone Energy** (SGY), and hospitality product and service provider **Wyndham Worldwide** (WYN). These stocks topped the Russell 2500 by 48%, 36%, and 28% respectively, since we initiated the positions.

Relatively small exposures to a few common risk factors had a negative impact on performance. Slight underweights to “value” stocks and the very smallest capitalization stocks coupled with a very small positive exposure to stocks with strong intermediate-term price momentum proved detrimental to active performance. Our worst-performing additions to the portfolio were **Rosetta Stone** (RST), **Sonic Automotive** (SAH), and **Covanta** (CVA). These positions underperformed the benchmark by 38%, 33%, and 24%, respectively.

Investment Team

Douglas W. Case, CFA
President
Chief Investment Officer



Jon Quigley, CFA
Managing Partner
Investment Management



Melissa R. Brown
Managing Partner
Investment Management



John D. Bright, CFA
Partner, Investment Management

Anatoly Reznik
Partner, Investment Management

Ratnakar (Ratna) Kota, CFA
Associate, Investment Management

Dmitri Prokhorov
Associate, Investment Management

Lyn Taylor
Associate, Investment Management

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 sharply increased the portfolio's exposure to the Utilities sector last quarter. New positions in the sector include **Unisource Energy Group (UNS)**, **Pinnacle West (PNW)**, and **SCANA Corporation (SCG)**. We also modestly increased our exposure to Health Care via purchases in **BioScrip (BIOS)** and **Endo Pharmaceuticals (ENDP)**.

We reduced our holdings in Financials and continued trimming our Technology exposure. In the Technology sector, we liquidated positions in **Priceline.com (PCLN)**, **Cray (CRAY)**, and **Cognex (CGNX)**. In the Financial sector, we liquidated positions in equity REITs **Essex Property Trust (ESS)** and **Rayonier (RYN)**, as well as bank holding company **Whitney Holding Corporation**

Top Active Weights - 09/30/09

Top Five Overweights vs. Russell 2500	Portfolio
Swift Energy	1.75%
W.R. Grace	1.72
GrafTech International Ltd.	1.70
Novellus Systems	1.65
Greenhill & Co.	1.63
Top Five Underweights vs. Russell 2500	Portfolio
CenturyTel	-0.49%
KeyCorp	-0.27
Red Hat	-0.26
Genworth	-0.26
Health Care REIT	-0.23

(WTNY).

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 2500 benchmark with a higher return potential. Stocks are included in the portfolio not only for their expected return, but also for their contribution to the portfolio's risk profile.

Purchases

McMoRan Exploration (MMR) engages in the exploration, development, and production of oil and natural gas offshore in the Gulf of Mexico and onshore in the Gulf Coast area. It also engages in the

incorporation of 3-D seismic interpretation, offshore drilling to total depths, and horizontal drilling. We purchased McMoRan on August 4th. Despite MMR's large debt load, its strong return on capital had our models rate the stock as attractive.

Unisource Energy (UNS) operates as an electric utility in Arizona. It operates through three segments: TEP, UNS Gas, and UNS Electric. The company's return on capital along with a bullish trading formation makes the stock attractive. We initiated a position on August 4th.

Pinnacle West Capital (PNW) operates as an electric utility that provides retail and wholesale electric services in Arizona. It involves in the generation, transmission, and distribution of electricity through coal, nuclear, gas and oil, and renewable resources. A third August 4th purchase, our purchase of Pinnacle West mirrors the market's appetite for risk; our models rated the stock highly in part due to the premium the market is paying for PNW's operating cash flow.

	Portfolio Weight	Russell 2500 Weight
Consumer Discretionary	14.54%	9.47%
Consumer Staples	1.24	3.67
Energy	7.21	5.02
Financials	17.08	19.64
Health Care	8.35	11.55
Industrials	7.81	9.01
Materials	6.91	7.19
Retail	10.20	5.70
Services	9.97	8.99
Technology	9.58	14.56
Utilities	7.11	5.20

Sells

Altra Holdings (AIMC) engages in the design, production, and marketing of various mechanical power transmission and motion control products in North America, Europe, and Asia. Despite AIMC's solid cash flow generating ability, the stock's short-term trading pattern appeared problematic, and thus we liquidated the position on August 4th. The stock had lagged the Russell 2500 by just over 2% during the holding period.

Potlatch Corporation (PCH) operates as a real estate investment trust (REIT) that owns and manages

timberlands located in the United States. It operates in five segments: New Resource, New Land Sales and Development, Wood Products, Pulp and Paperboard, and Consumer Products. Lousy return on capital figures were more than enough to overwhelm recent positive earnings surprises, and we sold the stock on August 4th. The stock trailed the Russell 2500's performance by almost 4% during the holding period.

Sealed Air (SEE) manufactures and sells packaging and performance-based materials and equipment systems worldwide. SEE moved into an overbought short term position, which in turn led to our sale of the stock on August 4th. The stock edged the Russell 2500 Index by about 7% 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 zipper 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.

Disclosure

The specific securities identified and described do not represent all of the securities purchased, sold or recommended for advisory clients and it should not be assumed that investments in the securities identified and discussed were or will be profitable. Holdings are subject to change over time. Individual client portfolios may vary. To obtain a list of all securities recommended during the past year, contact Advanced Investment Partners' marketing department at 727-799-3671.

Frank Russell Company ("FRC") is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto. The presentation may contain confidential information and unauthorized use, disclosure, copying, dissemination, or redistribution is strictly prohibited. This is an AIP presentation of the Russell Index data. Frank Russell Company is not responsible for the formatting or configuration of this material or for any inaccuracy in AIP's presentation thereof.

Standard and Poor's, a division of the McGraw-Hill Companies, Inc., is the owner of the trademarks and copyrights relating to the S&P Index. The product is not sponsored, endorsed, sold or promoted by Standard and Poor's. Standard and Poor's makes no representation regarding the advisability of investing in the Product.

The index performance figures are calculated in U.S. dollars and reported on a gross basis. The index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income. Fees, including but not limited to the advisory fee, transaction and custody charges, would reduce the return. For example, if an annualized gross return of 10% was achieved over a 5-year period and total fees (management, custody, transactional and all other fees applicable to a portfolio) of 1% per year was charged and deducted annually, then the resulting return would be reduced from 61% to 54%.

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

Use of names and/or logos referenced in this piece was obtained with permission from parties mentioned therein.

The investment views expressed here are those of Advanced Investment Partners, LLC only through the period ended September 30, 2009. Opinions and estimates offered constitute our judgement and, along with other portfolio data, are subject to change without prior notice. The views expressed are for general information only and are not intended to provide specific advice or recommendations. The information contained herein has been obtained from sources believed to be reliable. AIP does not represent that it is accurate or complete, and it should not be relied on as such. Actual clients' portfolios may or may not hold the same securities depending on the guidelines, restrictions and other factors of the specific portfolios.

Past performance is not indicative of future results.

©2009 Advanced Investment Partners, LLC

Contact

If you have any questions, please contact:

Laurie Watson, CIMA
Partner, Relationship Management
(727) 712-2981
laurie@aipllc.com

Advanced Investment Partners
100 Main Street
Suite 301
Safety Harbor, FL 34695

(888) 248-8324
(727) 799-3671
www.aipllc.com