

Institutional Diversified Large Cap Growth Strategy 2Q10

Market Review

The investment landscape in the second quarter was particularly difficult. Whether the “flash crash” quick one-day correction or the 10%-plus pullback in the second quarter, stock prices were volatile and trended lower. While the broad indexes lost value, security selection within our investment strategy contributed to weak results. With little money flow coming into the equity market, trends persisted, creating a challenging landscape for fundamental investors. Professional mutual fund investors are fully invested and retail clients are not increasing their exposure to risky asset classes. On the margin, the only thing changing is net exposure by hedge funds. With trading-oriented strategies acting as the marginal buyer or seller, short term data points rather than long term fundamentals dictated prices.

We believe this environment creates opportunities for long term investors, but on any given day it is very easy to look dumb. Volatility has spiked up dramatically, with the VIX index going from a low below 16 in April to an interim high above 48 in May. We are not standing still. As fundamental investors, we believe volatility creates opportunity, and knowledge of the fundamentals gives you confidence to act. While we may not always choose correctly, particularly in the short run, we believe our focus on sustainable growth and strong balance sheets will reward investors over time.

Strategy Highlights

On a year-over-year basis, turnover has increased substantially at approximately 23% in the first quarter and 15% in the second quarter. An early look at results indicates we are adding value in our decision-making process.

We are not dogmatic about what defines growth, but let the fundamentals and stock action dictate opportunities. While we look for large macro growth trends and try to identify companies that can exploit them, it is the opportunity and price rather than the sector or industry that defines a potential candidate. During the second quarter, we initiated positions in several different industries and companies: biotechnology via Alexion Pharmaceuticals Inc.; credit card processor Cielo; engineering and construction company Jacobs Engineering Group Inc.; and diversified manufacturer 3M Co. Performance in the quarter was disproportionately impacted by three securities: Nvidia Corp., Transocean Ltd. and BlackRock Inc.

Despite the near term challenges for these three securities, we remain invested. We continue to review our sell discipline and, despite contractions in price, we are unwilling to compound our short term mistakes by selling when we believe the opportunities are among the highest in terms of risk-reward ratios. In the case of Transocean, due to the unknown liability, we have instituted a sell policy if the security should violate a pre-determined floor price. In addition to the above mentioned trades, we liquidated our position in Research In Motion Ltd.

Market Outlook

It appears the U.S. government is committed to stimulating growth. While the specter of continued low interest rates could create inflation down the road, the near term effect will likely be faster growth. Perversely, the near term correction likely extends the duration of the recovery with stimulus programs and the jobs recovery likely pushed out. Nevertheless, corporate earnings are recovering and consumers are increasing their expenditures. The challenge is determining the

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sustainability of the recovery. If the recovery of consumer spending is being driven by a large swath of borrowers benefiting from the boost in disposable income by not paying their mortgages (created by the lag between delinquencies and foreclosures after people opted out of paying the mortgage on a house that is trading below cost), it will likely be more short term in nature.

Conversely, if balance sheets are slowly recovering and corporations expand their hiring, the duration of the cycle will be longer. Regardless, we think this creates a good environment for quality growth managers. Valuations have become more attractive and have compressed across the board, creating opportunities to trade up to better growth prospects. A slower growing economy with low to modestly higher interest rates tends to be a favorable backdrop for quality large cap growth assets. Their superior balance sheets would create a growing disparity between funding costs, and higher multiples could be expected to be rewarded at companies that can deliver growth.

We will continue to try to add value through security selection with a focus on trying to protect the downside while capturing the upside return. While we are frustrated by our short term results, we look to build on our solid results from 2009. Thank you for your support.

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