

Institutional Mid Cap Core Strategy

2Q10

Market Review

The stock market declined in the second quarter, with most of the major domestic indexes closing out the month of June at new lows for the year and recording the worst quarterly returns since late 2008. The broad S&P 500 Index¹ had losses of 11.43% for the quarter and 6.65% for the first half of the year, while the S&P MidCap 400 Index lost 9.59% and 1.36%, respectively, and the blue-chip Dow Jones Industrial Average lost 9.36% and 5.00% for the same periods.

The second quarter also saw a marked rise in volatility, as measured by the Chicago Board Options Exchange Volatility Index (VIX) – also known as the “fear index.” The VIX closed the month at over 34 – values above 30 are generally associated with higher levels of volatility and investor fear or uncertainty – a reading more than double the multi-year low near 15 set at the start of the quarter in April. There was no shortage of negative economic and fiscal news during the three-month period. These included concerns about the sustainability of the U.S. economic recovery and its ability to overcome a persistently high unemployment rate and a troubled housing market, the growing economic impact of the Gulf of Mexico oil spill, uncertainty about the potential impact of financial regulatory reform in the U.S., and the so-called “flash crash” of May 6 when the Dow plunged 700 points in just a few minutes.

Overseas, the sovereign debt crises of Greece and Spain, the weakening of the euro, and indications of an economic slowdown in China all added to investors’ fears and helped drive them from equities into asset classes perceived as safer, such as U.S. Treasuries and gold. Indeed, Treasuries recorded the best first-half returns since 1995, and yields on 2-year Treasury notes closed the quarter near an all-time record low. Gold reached record highs during the quarter. In short, confidence in the U.S. equity market fell significantly since the start of the second quarter, as did share prices.

Portfolio Highlights

On an absolute basis, for the second quarter the Strategy had positive returns in the consumer staples sector and negative returns in the other nine economic sectors in which we invested (out of 10 total). The greatest detractors from returns were in the financials, energy and information technology (IT) sectors.

Relative to the benchmark S&P MidCap 400 Index, for the second quarter overall stock selection detracted from performance but overall sector allocation contributed to it. In particular, stock selection in the consumer discretionary, consumer staples, materials and IT sectors contributed to performance but was offset by the negative impact of selection in the energy, health care and financials sectors. In terms of sector allocation, only the Strategy’s underweight in the consumer discretionary sector, which helped performance, had a meaningful impact for the quarter.

Over the course of the second quarter, we made a number of adjustments and changes to the Strategy. Considering the depressed values seen in the market during the quarter, we did seek to take advantage of the decline to pick up some new holdings and add to some existing holdings that had been beaten down. We

Brian Angerame **Managing Director, Portfolio Manager**

- 15 years of investment industry experience
- BA in Government from Dartmouth College

Derek Deutsch, CFA **Managing Director, Portfolio Manager**

- 10 years of investment industry experience
- MBA from Georgetown University
- BA from Brown University

¹ The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S. Please note that an investor cannot invest directly in an index.

PORTFOLIO MANAGER COMMENTARY



established new positions in a number of stocks, including Xilinx Inc. and Varian Semiconductor Equipment Associates Inc. (in the IT sector), Crown Holdings Inc. (materials), Bucyrus International Inc. and Alliant Techsystems Inc. (industrials), Peabody Energy Corp. (energy), Vanda Pharmaceuticals Inc. (health care), and Northwest Bancshares Inc., Old National Bancorp and Trustmark Corp. (all in the financials sector).

We also closed a number of existing positions during the quarter, including our holdings in Chimera Investment Corp. and Annaly Capital Management Inc. in the financials sector, AGCO Corp. in the industrials sector, and Li Ning Co. Ltd., Family Dollar Stores Inc. and AnnTaylor Stores Corp. in the consumer discretionary sector.

We feel it is important to reiterate that our Strategy's portfolio is constructed using a bottom-up approach based on fundamental research and stock selection rather than implementing a top-down strategy based on macroeconomic views. As such, our portfolio tends to have industry weightings close to those in our benchmark; however, our active security weight tends to be relatively high.

The leading individual contributors to Strategy performance for the second quarter included Fidelity National Information Services Inc. in the IT sector, Casey's General Stores Inc. in the consumer staples sector, AmerisourceBergen Corp. in the health care sector, Family Dollar Stores Inc. in the consumer discretionary sector and Agnico-Eagle Mines Ltd. in the materials sector. The bottom individual contributors to Strategy performance for the second quarter included Oceaneering International Inc. in the energy sector, Onyx Pharmaceuticals Inc. in the health care sector, Juniper Networks Inc. in the IT sector, Jarden Corp. in the consumer discretionary sector and Bristow Group Inc. in the energy sector.

ClearBridge Advisors

www.clearbridgeadvisors.com

800-691-6960

info@clearbridgeadvisors.com

Outlook

At the end of the first quarter, we voiced our concerns that the remarkable rally of the preceding months had pushed valuations to the point where we were still finding attractively priced stocks to invest in, but not to the extent we were at the start of 2009. We noted that psychology had become buoyant and that economic uncertainties, particularly employment and housing, remained, leaving the market vulnerable to a correction.

With stock prices now down approximately 16% from the April 23 peak to quarter end, we think the forward outlook has improved for equity returns. While economic uncertainty remains and we can't rule out conditions worsening from here, stock valuations are generally attractive and many of the businesses we own continue to perform at a high level. The second quarter's correction removed a lot of the "froth" from the market, and psychology has shifted on a dime from optimism to pessimism. These conditions combined with persistently low interest rates and stimulative government policies should provide some support for equities even if the economy doesn't cooperate. We are also encouraged by the increased M&A and private equity activity, which benefited two of our holdings during the period, and this is one of many reasons we think mid caps represent a "sweet spot" within the equity market.

Past performance is no guarantee of future results.

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