

After a sharp correction during the second quarter, the equity market rebounded during the third quarter with the Russell 2000® Value Index posting a 9.72% return. The market was quite different from month-to-month, however. In July, the Russell 2000® Value Index posted a strong 7.14% return, as the stock market bounced back after the second quarter correction. In August, concerns about the strength of the economic recovery began to weigh on the stock market and the Index dropped by 7.52%. Then, as fears of recession eased somewhat, the Index rallied 10.74% during September, providing one of the strongest Septembers on record.

Contrary to the second quarter, when higher profitability stocks were the small-cap market leaders, leadership was mixed during the third quarter. During the September rally, stocks of lower profitability companies actually outperformed, as did stocks of companies with negative earnings. This was a bit of a headwind for our higher quality style, and even though the Small-Cap Value strategy posted strong absolute returns for the quarter, it trailed its Russell 2000® Value benchmark.

In terms of the Russell 2000® Value sectors, the materials, consumer discretionary and information technology sectors had the best absolute performance for the quarter. This is not surprising, as these were some of the weakest sectors during the previous quarter as a result of the economic outlook turning significantly more gloomy. As economic indicators started to appear less negative during the third quarter, these sectors recovered. The weakest sectors of the Russell 2000® Value Index for the quarter were financials and telecommunication services.

Compared to its Russell 2000® Value benchmark, the sectors of the Small-Cap Value strategy that showed the strongest relative performance were financials, consumer discretionary and energy. In the financials sector, the strategy's underweight in commercial banks helped relative performance. An underweight in the health care sector and relative weakness in some of the strategy's information technology holdings, were the primary detractors from the strategy's relative performance.

We remain positive about the performance of the Small-Cap Value strategy over the next several quarters. Although recent economic data has been mixed, we expect a slow growth environment over the next few quarters that is likely to favor highly profitable, well-managed, attractively valued small cap stocks, which are the focus of our strategy. We believe that these companies will be rewarded going forward.

Past performance does not guarantee future results.

Reflects information for a portfolio that serves as the model against which each Small-Capitalization Value account is managed. The model portfolio is an actual account and the information provided will vary for other actual accounts. Portfolio holdings are subject to change. The Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000® Index measures the performance of the approximately 2,000 smallest companies in the Russell 3000® Index, an index representing approximately 98% of the investable U.S. equity market. Index performance information was furnished by sources deemed reliable and is believed to be accurate, however, no warranty or representation is made as to the accuracy thereof and the information is subject to correction. You cannot invest directly in an index, securities in the Composite may not match those in the index and performance of the Composite will differ. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns.

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