

After a strong first quarter, the equity market corrected sharply during the second quarter of 2010, with the Russell 2000® Value Index posting a -10.60% return for the quarter. Contrary to the last twelve months of economic recovery, signs of global economic growth have become mixed, and the risk of a double-dip recession began to be priced into the market. This has led to a significant change in market leadership. Earlier in the recovery, performance was led by many of the riskiest assets, including lower quality equities. During the quarter, however, higher profitability stocks took the lead, and this had a strong positive impact on the relative performance of the small-cap value strategy. While the strategy's absolute return reflected the negative tone of the stock market, it significantly outperformed its Russell 2000® Value benchmark for the quarter and was ahead of its benchmark on a year-to-date basis as well.

In terms of the Russell 2000® Value sectors, the utilities, consumer staples and telecommunications services sectors had the best absolute performance for the quarter. This is not surprising, as these sectors tend to be more defensive and less susceptible to an economic slowdown. They therefore received a boost from investors' growing skepticism about the strength of the economy. The weakest sectors were consumer discretionary, materials and energy. Compared to the Russell 2000® Value benchmark, the sectors of small-cap value portfolios that showed the strongest relative performance were financials, energy and consumer discretionary.

We remain very positive about the performance of the small-cap value strategy over the next several quarters. Companies with good balance sheets and high profitability levels started to outperform over the last few months. We would expect this leadership to continue, as we believe that the early recovery phase of the economic cycle has likely ended. We continue to focus on the stocks of small-cap companies that are profitable, well-managed, attractively valued and have strong balance sheets. We believe that these companies, which demonstrate strong relative fundamentals, 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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