

SMALL-CAP VALUE COMMENTARY LETTER FOURTH QUARTER 2007

PORTFOLIO PERFORMANCE

The markets sustained negative returns across all U.S. equity indices in the fourth quarter of 2007 with most of the downside occurring in November, as major financial institutions announced sizable losses related to the mortgage crisis. These ongoing negative announcements and uncertainties about the future growth of the economy left investors nervous, and as a result, they moved significant dollars out of smaller cap companies toward larger cap growth companies, which are generally considered by most to be the safest stocks. Growth outperformed value, and large-cap clearly dominated small-cap both for the quarter and for the year. The Russell 2000® and Russell 2000® Value indices reported negative returns; down 4.58% and 7.28% respectively for the quarter, and negative 1.57% and 9.78% for the year. As shown in the charts below, the smaller the market-cap and deeper the value, the more meaningful the declines were in the asset class. Additionally, companies with the lowest earnings visibility suffered extreme downside pressure, as is typical in the early recovery stages of our intrinsic value candidates.

Performance by Market-Cap Quintile

| Market-Cap Size Quintile | Russell 2000 Value Return |
|--------------------------|---------------------------|
| Q5 (Smallest) | -17.88 |
| Q4 | -18.70 |
| Q3 | -16.35 |
| Q2 | -9.11 |
| Q1 (Largest) | -4.39 |

Performance by P/E Quintile

| P/E Quintile | Russell 2000 Value Return |
|---------------------|---------------------------|
| Nonearnings Stories | -22.49 |
| Q1 (Cheapest) | -15.33 |
| Q2 | -13.65 |
| Q3 | -1.59 |
| Q4 | -3.92 |
| Q5 (Most Expensive) | -6.92 |

Source: ML Small Cap Research, LLC; Russell Investment Group

While the market did recover a bit from its mid-quarter lows, the small-cap value portfolios did not recover sufficiently from the sell-off, and ended lower than the indices.

In addition to the above pressures, smaller cap value companies endured additional pain as investors relentlessly tax-sold these undervalued names to offset capital gains in their large-cap or international portfolios. From our perspective, this was one of the primary contributors to portfolio underperformance in the quarter. This is an annual event that regularly leads to some exceptional buying opportunities in anticipation of recovery in these oversold names after tax-selling season abates. However, in a year that followed several good years, the selling was more intense and the values more compelling. The result was a year very similar to 1998 when small value performed especially poorly and ICM lagged the

indices. Although we saw some recovery in individual names toward the end of December, we expect good bounces in many of these names as they report results in late January and February. Current prices of many of these stocks now reflect the most compelling undervaluations in the past four or five years; and, we believe the pattern has been set up to potentially provide a period similar to the one that occurred after 1998. In the two and a half years following 1998, small-cap value significantly outperformed other classes of domestic equities and ICM significantly outperformed the small value indices.

Our portfolios have been significantly underweight in financials for quite some time, as we had anticipated the risks associated with the heated mortgage market and the subsequent meltdown. That decision, we are pleased to report, contributed positively to the portfolios as the financial services sector return for the Russell 2000 Value index was down 20.38% for the year. Although our underweight position contributed positively to performance, it was not enough to offset the downward pressure resulting from tax-selling our bargain candidates across many sectors. As is often typical in the early recovery stages of value names, some companies will miss earnings expectations before the market recognizes the turnaround and improving fundamentals. We experienced several missed earnings but are confident that these names are on the road to recovery over the next several quarters; indications from early reporting companies support our optimism.

The quarter did have some good news resulting in positive performance of individual companies, particularly in those companies that are closer to demonstrating stronger fundamentals and revenue expansion to investors. Most of the success came from companies in the technology sector and those garnering revenue growth from international sales.

While we are mindful of the overarching risks in this uncertain market environment, our small-cap value strategy remains focused on individual companies with strong balance sheets and unique niche markets that will drive demand and produce company earnings growth through achievement of their specific improvements. We are also emphasizing companies that derive a significant percentage of revenues from outside the U.S. as a buffer against the American-based economic slowdown.

Frankly, we have not seen relative undervaluation this extreme in small-cap value companies since the aforementioned 1998, when our portfolios underperformed the benchmark by more than 10%. There are always enough material differences in each economic and market cycle that one can never arbitrarily imply an identical outcome. But, we feel that the primary factors are so similar that a comparable period of out-performance is expected as market anxiety abates and investors refocus on each company's underlying fundamentals.



ECONOMIC OVERVIEW

The fourth quarter of 2007 saw a continuation of the economic themes that dominated the prior quarter. The woes of the credit markets, as exemplified by the large write-offs taken by major banks and brokers, stood front and center in the debate over our economic future. Policy makers engaged in a great deal of hand wringing, and the Federal Reserve tried to grease the wheels of the economy with easier short term interest rates. Such Fed action has helped the banks, but has caused borrowing to become increasingly more difficult for the consumer. Borrowers can no longer avail themselves of the ridiculously easy standards applied by lenders these last few years.

The tightening of credit availability has hurt many participants. The sub-prime mortgage market has gone on an extended hiatus, thus eliminating a significant slice of demand from the housing market, providing an impetus for declining home prices. The high-yield, leveraged loan market has also withered, which pulled the rug out from under what was a torridly hot LBO marketplace, in turn removing some support from stock prices. Clearly, the market has begun to reevaluate risk, pricing it to more appropriate levels.

The rear-view mirror shows the image of an economy that grew at a very decent pace in the third quarter, with GDP up 4.9%; yet, the data we follow on a regular basis paints a picture of a deteriorating economy. Was the third quarter's strength an anomaly? We suspect so. We do know that there are a series of key indicators that are flashing warning signs. The leading economic indicator's index has been negative three of the last four months. The ISM/purchasing manager's index indicated a contracting manufacturing sector last month. The unemployment rate has shot up by 0.6%, from its cycle low of 4.4% to 5.0%. These are clear warning signs indicating that the risk of a recession has risen significantly.

For an economy like ours, which lives on credit, the depth of the banking industry's balance sheet problems looms as a menacing unknown. Fortunately, the industry entered this new environment much better capitalized than it was at the beginning of prior crises. We think we will have more clarity by mid-February, as the large banking institutions will have to meet the demands of their auditors for adequate disclosure of their risks before they sign off on their year-end reports. Also, the Basel II international banking capital standards will be applied to the larger banks, which will cast a new light on the quality of their assets.

As we look forward, we see powerful countervailing forces at work, both for and against economic growth. On the positive side of the ledger, there is the belief that global growth is at least in part delinked from the USA's economy; this combined with the relatively cheap U.S. dollar, will result in a wave of export growth and a renaissance in domestic manufacturing. The boom in commodities is a benefit to American agriculture and mining exports, as well. Furthermore, we expect the Federal Reserve will continue to lower short-term interest rates in an effort to stimulate the economy. At some point, the credit markets

will re-assess credit risks, and realize they can differentiate between good credit risks and bad credit risks, in order to restore a more reasonable level of liquidity to borrowers.

On the negative side of the ledger, the housing market will not be recovering quickly, due to the reduction in credit capacity combined with the increase in lending standards. The nation's households are already highly leveraged, versus an asset base (principally, their homes) that is decreasing in value. Therefore, lower home values, higher oil prices, and a softer stock market may combine to reduce consumer spending in the coming year. Since the consumer represents approximately 70% of the U.S. GDP, this is a significant cloud on the horizon.

Overall, we see a slower U.S. economy in 2008, and companies with significant foreign sales being at an advantage over solely domestically oriented firms. Thus, our emphasis on finding companies with significant foreign sales, avoidance of exposure to the residential housing market, as well as ownership of some very over-sold stocks, helps position the portfolios for success in the coming year.

We request that clients advise ICM in the event that there are any changes in their investment objectives, financial situation, or whether they wish to impose or modify restrictions on the management of their account. Please call ICM at 800.488.4075 or visit our Web site, www.icmasset.com, if you have any questions or need additional information.

