

SMALL- to MID-CAP VALUE COMMENTARY LETTER FIRST QUARTER 2005

“The weather-cock on the spire, though made of iron, would soon be broken by the storm-wind if it . . . did not understand the noble art of turning to every wind.”

-Heinrich Heine on adaptability (1797-1856)

Current Market Environment

After experiencing a strong fourth quarter, the markets experienced a reversal of fortune in the first quarter of 2005, and generated negative returns. Indeed this turnabout began on the first day of the year and the entire month of January was negative. Investors got a brief respite in February with positive returns, only to have March end in negative territory. From a style perspective, small-cap growth stocks generated the worst quarterly returns. Investors were rewarded for risk in the fourth quarter, whereas the opposite was true in the first quarter.

Just a few of the issues investors must contend with are the increases in oil prices, the budget deficit, a slowing economy, and weakened profitability growth. It seems the euphoria of the election has worn off and the focus is now on the issues most pertinent to the markets.

Portfolio Performance

ICM's Small- to Mid-Cap Value portfolios experienced strong performance in the first quarter, as they outperformed the Russell 2500™ Value Index. It is notable that we were able to generate positive returns in the market whereas the index declined by more than two percent. Remaining true to our style, our sector weights did not mirror the index. This lack of correlation tends to affect performance relative to the benchmark; however, further examination of ICM's performance confirms that the effect from this was negligible in the fourth quarter. In fact, individual security selection was the leading contributor to our positive performance. Respective to sector performance, our underweight in financial services generated our best sector comparisons as this sector declined over concerns about rising interest rates.

In our prior commentary, we said that ICM could capitalize on the opportunities we uncovered in the market. Applying our vigorous bottom-up investment process, we were able to do just that. Your portfolio benefited from the fruits of our labor, as it was a solid quarter for our stock selections, especially in the health care sector.

As noted above, we are still underweight in financials. This strategy began to generate results last quarter, and as we continue to see these companies experience declining returns on equity, we remain convinced that there are no compelling reasons to increase our investments in financial stocks.



Looking Forward

Our view of the markets going forward remains steadfast. We continue to believe that there are risks to consumer spending because savings rates are low and debt levels are high. The budget deficit also continues to present challenges both from an expenditure perspective, and from the government's ability to continue funding the nation's debt through the sale of government securities to foreign countries. The potential for a continued rise in interest rates is another area of concern.

We believe the most significant issue facing the markets over the coming two years will be the declining rate of profit growth for corporate America. As earnings growth for the S&P 500 slows to a rate of around nine to ten percent for 2005, and between two to six percent in 2006, investors will likely be drawn to the appeal of higher earnings growth rates normally reserved for growth stocks. However, unlike most small- to mid-cap value stocks, which tend to generate low year-over-year growth, the stocks in your portfolio are well positioned going into this type of environment—this is because the companies in ICM's Small- to Mid-Cap Value portfolios tend to exhibit strong earnings growth characteristics. Another advantage of this disciplined investment process is our ability to discover unloved companies when they experience temporary operating difficulties. As efficiencies improve, your portfolio benefits from the relatively stronger earnings growth.

Overall, we remain optimistic that our unique style will continue to perform well in this subdued market environment, and that we will continue to uncover great new ideas for your portfolio going forward.

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.

