

# SMALL- to MID-CAP VALUE COMMENTARY LETTER THIRD QUARTER 2004

---

*“This is like déjà vu all over again.”*

-Yogi Berra

---

## **Current Market Environment**

In our last commentary letter, we noted that the uncertain nature of the economy, along with corporate profitability, would likely cause the market to experience continued volatility. Although the Russell 2500™ Value was positive overall for the quarter, a closer examination reveals that individual stock returns were indeed quite unstable. The strong rise in oil prices, continued unrest in Iraq, and the upcoming presidential elections were all uncertainties that served to exacerbate the already unsettled economic landscape.

During an unsteady market, investors often flee to investments that they believe are more secure, such as stocks with stable earnings growth. As a result, we saw that liquidity in the market’s small-cap arena — traditionally considered riskier by investors — dried up, especially regarding demand to purchase these types of stocks. For example, when a company pre-announced better than expected earnings, it might only see its stock price rise five percent; however, when a company pre-announced *negative* earnings, it then was more likely to see its stock price decline by an overwhelming 25 percent. As we expected, it was a difficult environment for most managers.

---

## **Portfolio Performance**

ICM’s Small- to Mid-Cap Value portfolios trailed the Russell 2500 Value Index for the quarter. A detailed analysis shows that the under-performance was equally due to sector exposure and security selection. Our overweights in technology and consumer discretionary negatively contributed to performance this past quarter. However, true to our absolute value style, we are capitalizing on the depressed prices in these sectors and discovering potential new ideas for your portfolio at what we believe to be good buys. More positive news is that the economically sensitive companies in your portfolio continued to perform well, and your exposure to both the oil and natural gas markets helped to balance negative performance of other sectors.

---

## Looking Forward

Because temporarily deflated prices create buying opportunities, our long term, opportunistic style benefits from the type of environment where stock declines are driven more by low liquidity than by actual earnings results. In fact, a review of ICM's performance for our Small- to Mid-Cap Value style confirms that we have historically bounced back from this type of environment with strong outperformance of the Russell 2500 Value in the following years.

Going forward, we continue to believe that the consumers will be hard pressed to increase, much less maintain, their current spending levels. Unfortunately, our nation's budget deficit will continue to constrain the government's ability to spend. The election will provide additional insight into the future tax environment, yet further tax decreases are unlikely.

Fortunately, our ability to succeed and generate further returns is by no means hampered by a subdued economic environment. Rather, we are encouraged that the new opportunities we see today will contribute to future success for your portfolio.

---

*We request that clients advise ICM and their financial advisor 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](http://www.icmasset.com), if you have any questions or need additional information.*