



## MID CAP VALUE EQUITY STRATEGY

3<sup>rd</sup> Quarter 2008 Commentary

### EQUITY MARKET REVIEW & OUTLOOK

Considering the state of the markets over the past several weeks, we expect that our readers are wondering where we go from here. Thus, we depart from our normal presentation and begin with our Review and Outlook.

Whereas a few months ago we were not sure that a recession was inevitable, the roiling of the global financial markets that began in September calls into question the health of global economies. To be sure, frozen credit markets have only served to break down the mechanisms that support business growth and consumer spending. Clearly, growth is slowing, not just here but worldwide.

The critical questions are: how fast and for how long? None of us is able to answer these questions, of course. We do not have a crystal ball, nor do we put much stock in those who pretend they do. The credit crisis that precipitated the economic deceleration is still evolving.

Like many in times such as these, we take a deep breath from the rollercoaster ride and re-anchor ourselves with timeless words of wisdom from those with vast experience. Value investor Warren Buffet provided those words, reiterating a fundamental principle, in a recent appearance on the Charlie Rose Show about the current economic environment. Mr. Buffet said:

*“The reason we [hadn’t] used our cash two years ago, we just didn’t find things that were that attractive. But when people talk about cash being king, it’s not king if it just sits there and never does anything. There are times when cash buys more than other times, and this is one of the other times when it buys a fair amount more, so we use it...**You want to be greedy when others are fearful.** You want to be fearful when others are greedy. It’s that simple...**I think confidence will come back.** I will tell you this. This country is going—[will] be living better 10 years from now than it is now.*

*It will be living better in 20 years from now than 10 years from now. The ingredients that made this country, you know the miracle of the world—I mean we had a seven-for-one improvement in the average American standard of living in the 20th century. Now, we had the Great Depression, we had two world wars, we had the flu epidemic. You know, we had [an] oil shock. You know, we had all these terrible things happen.*

*But something about the American system unleashed more and of a potential to human beings over that hundred years so that we had a seven-for-one improvement in—there’s never been any—I mean, you have centuries where if you’ve got a 1 percent improvement, then it’s something. So we’ve got a great system. And we’ve got more productive capacity now than we ever have. The American worker is more productive than he’s ever been. We’ve got more people to do it. We’ve got all the ingredients for a sensational future...I don’t want to hold out false hopes that the—by some magic moment, that things will turn around in a couple months because they wouldn’t, Charlie. I mean, and it’s a big mistake to try and mislead people. They will turn around. I don’t know whether it will be six months or whether it’ll be two years.”*

With these words we now take our eyes off the rear-view mirror and look forward to the road to economic recovery. This road may be longer and bumpier than we all hope or expect.

We believe as Mr. Buffet does that Americans have always found solutions to its problems no matter how formidable those problems seem. It will likely be weeks or months before the effects of the various government interventions are known. The details of the “rescue plan” still remain sketchy. No doubt, investors’ patience will continue to be tested, but we view this period as one of tremendous opportunity.

### 3<sup>RD</sup> QUARTER PORTFOLIO PERFORMANCE

As shown in the table below, our Mid Cap Value composite lost 12.16% gross of fees during the **third quarter of 2008**, compared with a decline of 7.5 % for our primary benchmark, the Russell Mid Cap Value Index. Our performance, while disappointing, follows a significant gain of 13.7% in the prior quarter.

For the **year-to-date period**, the HCM Mid Cap Value Composite declined 8.39% but considerably outperformed our benchmark, which posted a 15.46% decline.

Our sector and stock selection were negative for the quarter due in large part to the pullback in the energy and industrials sectors, where we have been over-weighted relative to our benchmark. For the year to date period, however, our sector and stock selection were positive.

| <b>Annualized Returns<br/>As of 09/30/08</b> | <b>3Q 2008</b> | <b>YTD 2008</b> | <b>1 Year</b>  | <b>3 Years</b> | <b>5 Years</b> | <b>10 Years</b> | <b>Since Inception<br/>01-01-88</b> |
|--|----------------|-----------------|----------------|----------------|----------------|-----------------|-------------------------------------|
| HCM Gross of Fees                            | <b>-12.16%</b> | <b>-8.39%</b>   | <b>-7.62%</b>  | <b>5.16%</b>   | <b>11.05%</b>  | <b>10.81%</b>   | <b>15.12%</b>                       |
| HCM Net of Fees                              | <b>-12.41%</b> | <b>-9.11%</b>   | <b>-8.56%</b>  | <b>4.12%</b>   | <b>9.97%</b>   | <b>9.77%</b>    | <b>14.03%</b>                       |
| Russell Mid Cap Value Index                  | <b>-7.52%</b>  | <b>-15.46%</b>  | <b>-20.50%</b> | <b>0.51%</b>   | <b>9.97%</b>   | <b>9.19%</b>    | <b>12.65%</b>                       |
| Russell Mid Cap Index                        | <b>-12.91%</b> | <b>-19.50%</b>  | <b>-22.36%</b> | <b>0.09%</b>   | <b>8.62%</b>   | <b>8.34%</b>    | <b>12.02%</b>                       |

*Performance results are determined with monthly valuations geometrically linked for period returns. The U.S. Dollar is the currency used to express performance. It should not be assumed that past performance is indicative of future results. Results are based on fully discretionary accounts under management, including accounts no longer with the firm. Returns are presented both before (Gross) and after (Net) of all fees, which may include management fees, legal, audit, tax and withholding tax on foreign dividends, where applicable and include reinvestment of all income. Net of fee performance are calculated using the highest advertised management fee. Gross of fee performance calculations are on a time-weighted, asset-weighted return basis and are before management fees, after commissions and after custodian fees. Net of fee performance are on a time-weighted, asset-weighted return basis and are after management fees based on an Annual Model Fee of 1.00% (100 Basis Points), after commissions and after custodian fees. Hahn Capital Management's advisory fees are described in Part II of SEC Form ADV. The equity segment returns of multiple-asset portfolios are included in the value equity strategy composite. Hahn Capital Management's returns from January 1988 to December 1998 reflect the equity segment of multiple-asset portfolios plus an allocation of cash in the amount of 5%, consistent with maximum cash level guidelines established by our institutional clients. Non-discretionary portions of an otherwise discretionary portfolio have been excluded when constructing composites.*

*The Index information contained herein has been obtained from sources that we believe to be reliable, but its accuracy and completeness are not guaranteed. It has been prepared solely for informative purposes. It is made available on an "as is" basis and should not be viewed as solicitation for business. The information contained herein may not be reproduced, in whole or in part, in any form, other than for your own personal, noncommercial use.*

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## PORTFOLIO ACTIVITY

### New Positions

**NeuStar, Inc (NSR)** – During the quarter, we initiated a position in Neustar, Inc. Neustar is the neutral, authoritative provider of clearinghouse services that enable communications service providers (CSPs) to manage critical activities such as record exchanges, subscriber changes, network optimization, content management, and inter-network call origination and termination. The company is the sole administrator of the North American Numbering Plan. The company also offers domain registry services, solutions for providers of VoIP (Voice over Internet Protocol), wireless data, and law enforcement compliance. Due to near-term concerns regarding CSP capital outlay and network optimization plans industry, we were able to purchase NeuStar at what we believe is a large discount to intrinsic value.

### Positions Increased

**Carter's, Inc (CRI)** – We increased our position in Carter's Inc., who, you may recall, is the global leader in the design, manufacture and marketing of children's clothing ages 0-7. We added to the position as we believe the company is rectifying its prior stumbles with its acquisition of OshKosh and felt the market was overly punishing the shares in the short-term. We continue to believe that Carter's will be successful in creating significant shareholder value, with or without OshKosh, and that it remains the premier company in its industry segment with tremendous financial strength and superior growth prospects.

**Host Hotels & Resorts (HST)** – We increased our position in Host Hotels & Resorts as its price fell during the quarter to a level that implied a future dividend yield of approximately 10%. Host continues to gradually re-engineer its world class portfolio of hotel properties, adding properties in supply constrained markets, selling others in less desirable markets and investing in high return on capital projects within its own portfolio. We continue to see Host building its Net Asset Value consistently over the next several years, supported by rising replacement costs, low vacancy rates and its joint venture efforts in overseas markets.

**Southern Union Co. (SUG)** – We increased our position in Southern Union as we noted an increasing gap between our estimate of intrinsic value and the value accorded to it stock in the public market.

Southern Union owns a world class network of distribution, storage and processing assets in the natural gas business and will continue to generate increasing levels of free cash in future periods due to planned project expansions and greater levels of profitability due to increasing scale and pricing.

**Hexcel Corporation (HXL)** – We increased our position in Hexcel Corporation following the announcement that the production schedule of Boeing Corporation's commercial aircraft has been halted due to a machinist's strike. In addition, the widening perception of a global economic slowdown has created fears that the large backlog for new commercial jet deliveries will be severely pared back. While we believe that both of these concerns are valid, we continue to expect that Hexcel has numerous business opportunities in the wind energy, military and other end markets that will support continued growth at Hexcel in the event that current business conditions in the commercial aerospace market deteriorate further.

**General Cable (BGC)** – We increased our position in General Cable. We believe that the company will continue to benefit from secular growth in new electrical infrastructure development in emerging markets and the growing need to re-develop existing infrastructure in the western hemisphere. General Cable has proven itself to be a very sophisticated acquirer of companies and assets that will differentiate its ability to serve and grow to meet the needs of these markets.

**SEI Investments, Inc. (SEIC)** – We added to our position in SEI Investments as the decline in equity markets in the first half of 2008 has negatively affected the market's perception of the firm's long-term earnings power. We continue to observe that SEI's product and service offerings are taking market share and expanding profitability while the stock market is concentrating on near-term stock and bond returns, creating an opportunity to buy at prices well below our estimate of intrinsic value.

**Key Energy Corp. (KEG)** – We added to our position in Key Energy during the quarter as business activity in Key's important markets continue to accelerate, while Key continues to generate significant free cash flow which it is deploying toward acquisitions, share repurchases and expansion of its base business. Key currently sells for less than 3 times its 2008 estimated operating cash flow; it is the market share leader in the North American well services business with close to a 40% total market share.

## **Positions Reduced**

**Wabtec Corp. (WAB)** – We reduced our position in Wabtec Corp as its shares have appreciated by more than 40% in 2008 and reached our near-term price target. Wabtec is one the best practitioners of “lean” manufacturing, striving to continuously reduce costs and improve productivity at its core business of manufacturing locomotives and other railroad and rail transit related components. Wabtec continues to expand overseas and has considerable additional opportunities to use its superior balance sheet to finance future acquisitions that are complementary to its core business.

**Carter’s Inc. (CRI)** – Late in the quarter, we sold out the incremental shares we had added earlier in the quarter. In the interim six weeks, the shares had moved up more than 33% and the position had become outsized in the portfolio. We reduced the position to lock in those gains and to better balance the risks of the overall portfolio.

## **Positions Sold**

**Varian Medical Systems (VAR)** – We sold our position in Varian Medical Systems during the quarter, concluding what is our single most successful investment. After closely examining the long-term outlook for Varian, we concluded that its valuation fully reflected the company’s future growth prospects.

## **PORTFOLIO STRATEGY**

Our portfolio strategy will remain focused on managing portfolio risk in what is clearly one of the most challenging periods in stock market history. Towards this objective, we are closely examining the changes that are taking place in the U.S. economy, as well as in the broader global economy, in terms of their impact on our companies’ future growth prospects.

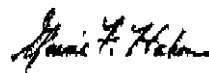
At the company level, we have reviewed each of our company’s balance sheets to identify any credit or financing issues that might limit the company’s ability to achieve their growth objectives. A key strength of our portfolio is that most of our companies are able to finance their growth through internally-generated cash flow and are therefore not dependent on the credit markets.

The broad-based fear and uncertainty have led to a generalized global financial panic, and many investors have sold stocks indiscriminately. As a result, we now observe that in many sectors of the market, stock prices appear divorced from company fundamentals.

We are reminded of the tremendous investment opportunity that presented itself following the terrorist attack on 9/11. There was a similar level of despair, albeit of a different nature, that gripped Americans as we pondered the implications of that terrible event on the future of our country.

Our experience tells us that the best time to invest is during periods of exaggerated pessimism, just as Mr. Buffet suggests. Looking back a year from now, we believe that this difficult market environment will prove to have been the best time in many years to invest in high-quality businesses at bargain-basement prices.

As always, we welcome any comments you may wish to share with us.



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