GROWTH EQUITY PORTFOLIO REVIEW

Third Quarter 2010

MARKET COMMENTARY

It never fails: as soon as the business press calls attention to a particular historical characteristic or trend relating to the performance of the U.S. stock market, the opposite is bound to occur. Such was the case this past month. After touting the fact that September is historically a difficult month for the equity market, numerous media sources proffered various remedies for what investors might do to protect themselves. Woe to those who swallowed that advice! The stock market did just fine in September, with the S&P up 8.9% for the month and carrying the quarter to a positive 11.3% finish. While September's strong showing may have muted the cries of the 'September Slump' theorists, it did nothing to mute the volatility swings that have characterized the market's behavior so far in 2010…or for the last three years for that matter. July showed strong performance after a dismal June, but August followed with weak price movement.

Can any wisdom be drawn from the volatility of the market over the past several months? World securities markets generally have been reflecting the fact that the strong economic rebound of 2009 is moderating, especially in developed countries such as the U.S. The markets' tendency to seize any and all pieces of economic news and to draw secular conclusions from single data points has led to manic price rushes both up and down. Our observation, certainly not unique, is that the remarkable credit-fed U.S. consumer of the mid-2000's remains constrained by outstanding debt in 2010, as are small U.S. businesses that rely on internal cash flow and back-supplied credit. This continues to limit the activity of U.S. small-businesses, normally a prime source of employment. Things are quite different (better) however in other parts of the world, and therefore for those companies exposed to these higher growing regions no matter where their headquarters are domiciled. Consequently U.S. companies that have exposure to markets in developing countries continue to experience nicely growing sales. Combined with very accommodating bond markets, the outlook is actually quite positive for publicly traded U.S. companies, especially those that can tap the securities markets for additional capital. Remarkable still is the Fed's policy: we are amazed by the current stance of the U.S. Federal Reserve, and wonder why markets everywhere aren't zooming up. But the aforementioned credit squeeze on consumers and small businesses is keeping the fabulous amount of liquidity on bank balance sheets, including those of foreign central banks.

When will we break out of this lethargy in the U.S.? There is some reason for optimism…faint, but real. In the early stages of a typical recovery, economic productivity is high as companies' revenue and income rise with their greater utilization of unused capacity created by the slowdown. However, as economic activity picks up, productivity declines as overtime and other expensive tactics to extend capacity are employed. It seems that because U.S. companies are still ill-at-ease in the current economic environment, they are doing everything in their power not to hire full time equivalent employees. Yet at some point, they must begin hiring – they have to – and when that time comes, it will mean higher consumer income. We do not expect a mad employment rush, but a steady increase in employment, especially in skilled jobs.

PERFORMANCE NOTES

	Periods Ending September 30, 2010					
	Quarter	Year-to-date	1 Year	3 Years	5 Years	10 Years
Growth Equity Composite – NET	**13.6%**	**11.3%**	**17.3%**	**-2.7%**	**3.2%**	**1.6%**
S&P 500 Index	11.3%	3.9%	10.1%	-7.2%	0.6%	-0.4%
Russell 3000 Growth Index	13.0%	4.8%	12.8%	-4.3%	2.1%	-3.2%

Composite performance is reported **NET** of fees and expenses. Please refer to the disclosures at the end of this report.

Our Growth Equity strategy kept pace with a very strong general market for the third quarter, as measured by the S&P 500, preserving the significant outperformance achieved during the first quarter's more moderate rise and second quarter's meltdown. This return pattern is consistent with the strategy's unconstrained, style-agnostic investment approach. Our opportunity set, unfettered by market cap or benchmark limitations, is designed to facilitate the construction of portfolios focused on high conviction ideas yet diversified across market and company-specific risks. If we do our job right, we should be adding significant value (alpha) over the long-term, no matter if markets move up, down, or sideways over the short-term.

There were several bright spots on the upside during the quarter including **Crucell (CRXL)**, up 83%, **Aruba Networks (ARUN)**, up 54%, and **Cytori (CYTX)**, up 39%. We've written about Aruba and Cytori in recent quarterly reviews, and will spare you a repeat of those discussions. The surge in Crucell, one of our biotech/vaccine development theme holdings, was due to a takeover offer from Johnson & Johnson, which was seeking to turn its partial stake in the company into full ownership. Crucell, which is engaged in developing, producing and marketing products to combat infectious diseases, initially attracted our attention several years ago because of its unique biopharmaceutical production platform called PER.C6, a platform it developed and then licensed to other biotech researchers and manufacturers. In more recent years, the company has developed, and in some cases commercialized, various products including vaccines for influenza and potentially for Hepatitis A and Hepatitis B. Crucell's efforts attracted Johnson & Johnson first into a strategic partnership (September 2009), and now into a takeover. We believe the price is more than fair and will sell out the position as tax considerations allow.

Turning to the portfolio's underachievers, we encountered poor performance from a few minor positions: **Vical (VICL)**, down 29%, **MAKO Surgical (MAKO)**, down 24%, and **BioLase Technology (BLTI)**, down 21%. Vical, a Growth Equity holding since early fall of last year, engages in the research and development of biopharmaceutical products based on its deoxyribonucleic acid (DNA) delivery technologies for the prevention and treatment of serious or life-threatening diseases. In line with our general enthusiasm for healthcare and biotechnology stock investing, we were particularly excited about Vical's therapeutic product for the treatment of a disease called critical limb ischemia, or CLI, a disease affecting wounds to the lower limbs. However, given the sizeable enterprise risk embedded in this stock (due to its small size and the nature of its industry), we limited portfolio positions to a cautious 2%. Since the initial purchase, the stock bounced around within a reasonable range, until just a few days before the quarter's end, when news of the product's disappointing Phase III clinical trial was released. Although Vical has a deep pipeline, we are wary about the company's next major drug candidate to go to Phase III trial, and are evaluating our exit strategy options.

MAKO, a maker of robotic surgery machines used mainly for orthopedic procedures, was added to the portfolio as a 2% position at the end of last year, at about $10.50 per share. Our investment thesis for MAKO involved a leading technology with multiple revenue sources (i.e., great business model), a strong management team, and reasonable current valuation. Other investors seemed to share our outlook, as MAKO's stock price rose strongly and hovered generally between $13 and $14 a share until their second quarter earnings call in mid-July. MAKO reported generally good system sales for the second quarter, but the number of procedures (from which MAKO earns additional revenues off the sale of related 'parts') was less than expected. Not able to meet Wall Street's prior expectations for continued high growth in the number of procedures, the company's stock has been on a downward trend since then. Looking ahead, we are as concerned as others about lower healthcare spending in general, with surgical procedures, hospital stays, and even drug sales showing signs of recession-based weakness. We recognize that MAKO's near term growth may not be as high as expected, but we still appreciate MAKO's business model. And at the current $10 price level, we believe there remains sufficient upside potential to continue holding the shares.

BioLase is a medical technology company specializing in laser systems used in dental surgery. We have followed the company for years, believing that their laser technology was exceptional, but had held off buying its shares

because the company's business model was weak. The company initially offered only one very expensive machine, and did not offer a related line of consumables that would provide a steady stream of high margin revenues. When new management took over in 2007/2008 and set about to expand the product line and add the consumables component, we began adding small BioLase positions to Growth Equity portfolios. The shares were certainly undercut by the 2008 market collapse, but then strongly participated in 2009's bounce back. This past quarter's drop was in response to a July announcement of a management upheaval that included the cancellation of an exclusive marketing agreement with **Henry Schein (HSIC)**, a leading distributor of healthcare products and services (and a Growth Equity holding). The new management, led by CEO Federico Pignatelli (who really isn't new – he held the same position prior to the 2007 management change), has worked out a revised agreement with Schein, and recent sales figures are improving. We still believe in BioLase's technology and in the demand trend for laser technology applications, and we further believe, after discussions with Mr. Pignatelli, that he will follow through on the prior management's plans to implement a more profitable and stable business model for BioLase. The stock remains a small position in Growth Equity portfolios.

PORTFOLIO ACTIVITY

There was a bit of turnover in Growth Equity portfolios during the quarter. In September we liquidated the strategy's approximately 3% position in **Cephalon (CEPH)** and put the proceeds to work in several new names: **Masimo (MASI)**, **IPG Photonics (IPGP)**, and **Incyte Genomics (INCY)**. Cephalon is a relatively mature, mid-cap biopharmaceutical company that attracted us with a strong product portfolio and reasonable valuation. Our expectation when we first bought the stock in mid-2009 was that the strength of the company's unfolding commercialization efforts would provide both growth and stability (downside protection) to our Growth Equity portfolios. This past August Cephalon announced that its founder and CEO, Frank Baldino, was taking a medical leave of absence. We are not optimistic about Dr. Baldino's return, and believe his absence may have a significant negative impact on the company's future. In addition, although we expect Cephalon's introduction of Nuvigil will be successful, generic competition is on the horizon. Taken together, these factors reduced the stock's attractiveness relative to other opportunities.

All three of our third quarter additions are smaller capitalization names that share some of the classic opportunity traits we favor for Growth Equity portfolios: each is exposed to a strong growth trend, and each possesses a scientifically derived intellectual property advantage over competition (a source of pricing power). As described below, however, their risk profiles are less similar, leading us to differentiate between them in terms of portfolio position size.

Masimo is an established medical appliance and equipment manufacturer that specializes in patient monitoring instruments used in critical care settings. One of the company's product lines measures the oxygen saturation level of arterial blood, a process called pulse oximetry. Similar to MAKO Surgical, a slowdown in surgical procedures may also affect Masimo. However, Masimo is in the midst of what is regarded as a successful effort to strengthen its business model by moving beyond critical care applications with products designed for general hospital care and even in alternate care settings. And there are other aspects of the company's strategy we find attractive: a substantial intellectual property portfolio (for pricing protection), a replacement sensors business (for steady, high-margin recurring revenues), and limited capital requirements. Add to that a supporting trend (demand for healthcare technology) and appropriate valuation, and Masimo in our minds warranted a relatively large 3% initial position. The allocation would have been higher except for questions about sustainability of a stream of royalty payments awarded to Masimo a few years back as a result of a legal dust-up with a competitor. The royalty payments are not material to our investment thesis, and we prefer to treat their potential continuation as a pleasant bonus as opposed to an unwelcome disappointment.

Our attraction to IPG relates to our fascination with the development and application of lasers, particularly fiber lasers. Fiber lasers, a relatively new class of laser technology, allows for very precise cutting at very small

measurements, and is particularly applicable to the fine processing of materials sold into the automotive, semiconductor, aerospace and medical device industries. Fiber lasers also offer lower costs, better handling, and higher quality characteristics to the users of these devices. IPG appears to us to be the best way to play this trend. The company is the market leader due to its significant intellectual property, low-cost production facilities, and decent marketing organization. Given IPG's superior cost structure and pricing advantage, we are confident in the company's growth prospects, and are therefore willing to accept the market's higher valuation for the company's shares. That said, recognizing the additional valuation risk we're adding to the portfolio, the stock's initial position size was limited to approximately 2%.

Lastly, we established a position in Incyte Genomics, a pharmaceutical development company that has significant drug treatments in development for both cancer and inflammatory diseases. The company is in partnership with Novartis on INC424, a drug to treat a blood cancer disorder called myelofibrosis. The recent release of very positive Phase II trial results for INC424 was yet another positive sign of progress for the company and a boost for the stock. However, Incyte, like other small, pre-commercialization drug discovery companies, is long on promise but short on revenue. Incyte's enterprise risk is a major factor in our investment thesis. Accordingly, it was given a smaller portfolio position size, less than 2%.

LOOKING AHEAD

There has been much discussion surrounding this fall's elections, and for good reason: they're quite important. In the past two years, the current administration and Congress passed legislation that will not only necessitate higher taxation in the future, but also introduces regulatory obstacles to private industry with little in the way of more effective oversight of those industries. Like many, we expect the Republican Party to reclaim some of the representation it lost in the last Presidential election, but we all must wait to see what legislation actually makes it out of Congress and is signed into law. We doubt we're going to rush out and make big moves the day after the elections.

What would we like to see from Washington pertaining to economic matters? First, we hope to see the Bush tax cuts, set to expire at the end of this year, maintained. It is imperative that the current rate structure be preserved while the economy continues its slow recovery. A second subject of concern is trade. There seems to be an increasing level of belligerence in the trade and currency talks between China and the U.S. We agree that China should allow its currency to rise, but for the U.S. to pick a fight with China right now seems unwise. Trade sanctions potentially used by both sides to induce a change in currency value would act as a tax on both economies. If this November's elections result in a more even playing field between the two parties, we can only hope that it will lead to less rhetoric and more sober discussions concerning the towering twin issues of taxation and trade. If taxes are allowed to rise and trade sanctions become a reality, it would in our opinion foster an environment less conducive to growth. Though we never promise anything, a more conservative handling of our clients' equity portfolios is our likely reaction.

DISCLOSURES: The Growth Equity Composite is comprised of discretionary equity accounts managed for growth. Accounts are included in the composite at the beginning of each account's first full calendar month under management. Results are calculated internally using the Advent investment management software and information provided by outside custodial firms. Performance figures are net of fees and commissions. Client returns may be reduced by other expenses incurred in the management of a client's portfolio. The composite calculation has been weighted for the size of each individual account. Composite and index performance reflects the inclusion of dividends, interest and other earnings, if any. All performance figures for periods one year and greater are annualized. Valuations and returns are computed and stated in U.S. Dollars. Performance results for individual accounts may vary due to the timing of investments, fees, size of positions and other reasons. Additional information regarding policies for calculating and reporting returns is available upon request. PAST PERFORMANCE SHOULD NOT BE CONSTRUED AS A GUARANTEE OF FUTURE PERFORMANCE. The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and the reader should not assume that investments in the securities identified or discussed were or will be profitable.

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