

# GROWTH EQUITY PORTFOLIO REVIEW

## *Third Quarter 2009*

It is always easier to write a quarterly report after a quarter like this past one. If every period could deliver 14+% returns, we would all be happy campers indeed! We find it much more productive in our reviews, however, to delve into WHY performance was good (or bad) and attempt to garner insights as to how we can continue to be better portfolio managers. Often it is helpful to review what we were thinking (and saying) when the market was a lot cloudier, because often it is during those dark days that portfolio managers can make the gravest errors.

It has been said that during relentlessly down market periods, having a stock that goes down daily is akin to having a painful cut on your hand. No matter how hard you try and avoid the pain, constant use of the hand reminds you of the cut. A “solution” is to go to the hospital and request that they amputate your hand. After all, if the hand isn’t there anymore, it won’t cause any pain. While such an action is absurd, the reality is that many portfolio managers effectively do the same thing: If they sell the stock that is down tremendously, then they won’t have to look at it anymore or work to ascertain its future. While selling that stock has eliminated the source of “pain”, the portfolio managers may have effectively amputated their future performance.

Looking back at a portfolio review from the third quarter of 2008, we listed a litany of things we didn’t know at the time, such as the length and depth of the credit crisis, the continued strength or weakening of China and India, the identity of next president, etc. But we also pointed out something we DID know: regardless of all of the aforementioned, creative spirit was alive and well in the US, and our Growth Equity investments were based on that assumption continuing.

The recent quarter and year-to-date performance, as reported below, is testament to the fact that when people pull their heads out of the bunker, money flows back into creative spirit.

	Periods Ending September 30, 2009						
	Quarter	Year-to-date	1 Yr	3 Yrs	5 Yrs	7 Yrs	10 Yrs
<b>Growth Equity Composite - NET</b>	<b>14.4%</b>	<b>20.9%</b>	<b>-5.6%</b>	<b>-2.2%</b>	<b>3.2%</b>	<b>10.5%</b>	<b>3.2%</b>
<i>S&amp;P 500 Index</i>	<i>15.6%</i>	<i>19.3%</i>	<i>-6.8%</i>	<i>-5.4%</i>	<i>1.0%</i>	<i>5.8%</i>	<i>-0.2%</i>
<i>Russell 3000 Growth Index</i>	<i>14.1%</i>	<i>27.3%</i>	<i>-2.2%</i>	<i>-2.5%</i>	<i>2.0%</i>	<i>6.0%</i>	<i>-2.3%</i>

Growth Equity Composite performance is reported **net** of fees and expenses. Please refer to the disclosures on the reverse.

## PORTFOLIO COMMENTARY

**Microvision (MVIS)** is probably the best example of a stock that was pushed to extreme low levels late last year. Due to substantial progress made towards commercialization of its digital light processing products, the stock has roared back this year. MVIS has developed a laser based projector that is as small as a pack of cigarettes. Instead of employing thousands of mirrors as touted by the Texas Instrument ads for their television set chips, the MVIS system is based upon one mirror that rotates at blinding speeds on a spindle. This “Pico” unit, when either wired or wirelessly connected to a media source (computer, iPod, etc.) can then project a very crisp image on a screen, wall or even a piece of paper. While we had hoped that the system would have been ready for last year’s Christmas season, it may have been fortuitous that it wasn’t, since the improved product they are about to go into production with is significantly better than the version we tested at an electronics show in early 2008. Announcements of an OEM (original equipment manufacturer) relationship and a large order boosted the stock recently, such that MVIS is up almost eighty percent for the quarter and two hundred and eighty percent for the year-to-date. While the company has other products in the pipeline that

make us bullish long-term, we will be keeping close tabs on our MVIS position size going forward since investors will now be focusing more on the valuation of the company's stock than on the viability of the technology.

One of the new names in the portfolio is a company called **Rovi Corp. (ROVI)**. Rovi has an attractive business model, one we not often see or can purchase at a reasonable price. Rovi's primary business is owning the software that sits on both a consumer electronic device and at the service center of a local cable or satellite provider, allowing a subscriber to use the service provider's online program guide. The software facilitates the automated use of digital video recording, channel presets and other features. Rovi makes its money in two ways: it collects a royalty from consumer electronics makers (such as TiVO) each time they sell one of their units, and it collects a monthly royalty from the service provider per subscriber. Rovi's capital requirements are fairly low and its revenues are stable and growing. Given the royalty nature of the revenues, margins are quite high. Trends are also in Rovi's favor, given the foreseeable higher penetration of cable and satellite services in both Europe and developing economies. At the time of purchase in early July, Rovi was selling for about thirteen times 2010 earnings estimates and after it's more than forty percent rise through the end of September is now selling for about seventeen times 2010 earnings estimates. Though we don't confine ourselves to comparable earnings multiples as a valuation tool, we believe Rovi is still an attractive holding despite its recent run-up.

Two Growth Equity companies whose stocks have not participated in this year's run up are the two largest U.S. telecom service providers, **AT&T (T)** and **Verizon (VZ)**. Our reason for holding these two remains straightforward: rising wireless data usage, spurred on by greater penetration of wireless data devices, will generate more than enough profit growth to offset declining wireline revenues, and will not only support but grow the very healthy dividends paid. Currently providing dividend yields of over 6%, we believe these two companies will continue to raise their dividends as earnings grow. With investment grade bond yields generally below the dividend yield offered by AT&T's and Verizon's common stocks, we believe these two positions offer a reasonable - and stable - return element to our Growth Equity portfolios.

## MARKET OUTLOOK

As we continue to monitor the economy's strengthening condition, our predilection is to use that trend and look for companies whose business model allows them to benefit from the operating leverage that virtually always occurs after a business slowdown starts to improve. While the consistency with which this leverage occurs is almost like clockwork, the challenge is that not all companies who cut costs during a downturn will benefit from an improving economy. And of course, the timing of any company's revenue rebound is always a key part of the puzzle.

If there is one economic uncertainty that makes us most nervous, it is the almost dire condition of state and local budgets around the country. Public corporations, with a mandate to create shareholder value, are quick to cut costs and fat as business turns downward. That process of self-reflection not only makes the company more profitable (or less unprofitable in the downturn), but forces the company to prioritize its use of capital both monetary and human. Unfortunately, due to politics of every persuasion, government entities never seem to go through the cleansing process that is so important to the sustained health of any organization. While the federal government can print stimulus monies, virtually every other budget needs to be balanced. We have never before had a situation where some major parts of government spending were contracting at the time we were pulling out of a recession. This situation warrants close attention.

As we have reiterated many times, trend, business model and valuation are all equally important considerations in our stock selection process. While the evidence is currently pointing us towards economically sensitive companies with good business models selling for attractive valuations, if in the future we see the economy double dipping, we will be quick to redeploy assets into stocks whose trend is less dependent upon the economy's overall health, but whose business models and valuations remain attractive.



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. PAST PERFORMANCE SHOULD NOT BE CONSTRUED AS A GUARANTEE OF FUTURE PERFORMANCE. Further information regarding policies for calculating and reporting returns is available upon request. Composite information displayed according to the Global Investment Performance Standards (GIPS) is available upon request.