



Thomas E. Browne Jr., CFA
*Senior Vice President,
 Portfolio Manager*

Tom Browne is Portfolio Manager for Oppenheimer Capital's Small Cap Value and Small Cap Core strategies.

Prior to joining the firm in 2003, he held portfolio management and equity analyst positions at SEB Asset Management and Palisade Capital Management. Mr. Browne has 23 years of industry experience. He holds a BBA from the University of Notre Dame and a MBA from New York University's Stern School of Business.

Since assuming responsibilities for OpCap's Small Cap Value and Small Cap Core strategies, Tom has consistently outperformed their respective benchmarks.

Investment Opportunities in Small Cap Value Stocks:

Achieving a Sustainable Alpha Source

Conventional wisdom asserts that sector-neutral strategies equate to closet-indexing, accruing whatever the market brings without the potential for meaningful outperformance. But our research suggests otherwise. Within small caps, performance dispersion between the best and worst performers is so wide that it creates plenty of room to generate alpha utilizing a sector-neutral policy.

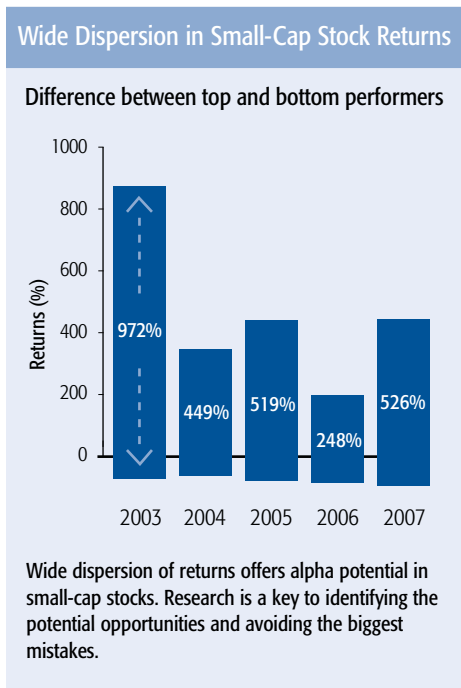
Our analysis further suggests the inter-sector performance dispersion is meaningful enough that it's not necessary to take on big sector bets. According to Small Cap Value Portfolio Manager Tom Browne, rigorous fundamental research and analysis enables bottom-up managers to capitalize on the higher potential for excess returns. We recently spoke with Tom about Oppenheimer Capital's successful approach to small-cap value investing.

Why does OpCap believe a sector-neutral approach makes sense?

The small-cap market is volatile. Sector bets could help one year, but hurt the next. We believe that it's possible to capture alpha without exposing portfolios to this risk and volatility. So we remove the sector bets and focus almost exclusively on stock selection. This way our approach and alpha potential do not rely on the market's direction or strength.

While sector-neutral strategies are sometimes equated to closet-indexing, we see it differently. There is plenty of room to outperform within a sector-neutral policy in large part due to performance dispersion. Historically, this dispersion has been so wide that it has offered a rich hunting ground for sharp bottom-up stock pickers. *(See chart at left)*

The cornerstone of OpCap's investment philosophy is that fundamental research insights can generate alpha. Our commitment to bottom-up stock selection dates to 1969, and we don't stray from this philosophy when managing small-cap value mandates.



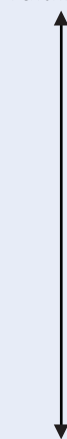
Past performance is no guarantee of future results. Source: FactSet

Sector Performance Volatility Adds Unnecessary Risk to Portfolios

GICS® Sector Returns of Russell 2000 Value Index (2000–2007)

This table highlights the uncertainty inherent in small-cap markets. The top performing sectors do not always repeat, and they often rank among the bottom performers immediately following a period of out-performance. By focusing almost exclusively on stock selection, we remove the risk and volatility of sector bets from our portfolios.

Strongest Performance



Weakest Performance

	2000	2001	2002	2003	2004	2005	2006	2007
	Health Care 112.13	Consumer Staples 58.99	Financials 2.99	Telecom. Services 91.87	Energy 55.77	Energy 39.74	Telecom. Services 53.39	Materials 24.01
	Energy 87.90	Consumer Discretionary 31.19	Utilities -7.62	Information Technology 76.16	Materials 37.30	Industrials 12.89	Materials 47.31	Health Care 14.68
	Utilities 43.84	Information Technology 23.38	Energy -8.64	Health Care 67.40	Industrials 26.67	Health Care 3.12	Industrials 28.73	Energy 39.74
	Financials 27.28	Financials 15.21	Materials -10.42	Energy 44.74	Financials 22.49	Materials 3.04	Consumer Staples 26.93	Consumer Staples 2.68
	Consumer Staples 6.18	Industrials 13.58	Industrials -12.04	Consumer Discretionary 44.63	Consumer Staples 19.66	Financials 2.38	Utilities 26.05	Telecom. Services 2.21
	Consumer Discretionary 3.75	Materials 12.56	Consumer Staples -13.92	Materials 42.64	Consumer Discretionary 18.67	Utilities 0.38	Financials 20.00	Industrials 1.23
	Industrials 1.04	Health Care 7.28	Consumer Discretionary -15.40	Industrials 41.57	Utilities 17.52	Telecom. Services -0.69	Information Technology 19.48	Utilities -2.47
	Information Technology -5.15	Utilities -6.66	Health Care -23.21	Financials 40.07	Health Care 15.17	Information Technology -1.11	Health Care 18.41	Information Technology -4.36
	Materials -6.78	Energy -18.28	Information Technology -39.06	Consumer Staples 35.67	Information Technology 5.07	Consumer Staples -2.05	Consumer Discretionary 17.64	Financials -21.56
	Telecom. Services -68.16	Telecom. Services -23.29	Telecom. Services -55.50	Utilities 27.05	Telecom. Services -18.62	Consumer Discretionary -3.10	Energy 16.03	Consumer Discretionary -29.44

Past performance is no guarantee of future results. Source: FactSet

Is there any data that supports your portfolio construction approach?

We recently did a comprehensive study of small-cap stock returns since 2000. We sorted all stocks capitalized between \$200 million and \$2 billion into their respective GICS® sector buckets. We then split each sector’s constituents into performance quartiles. (See table on following page)

There were four key takeaways we uncovered while doing this research:

- ▶ The data indicates that the top quartile performers beat the bottom-ranked fourth quartile stocks by a substantial amount; combined, the average inter-sector gap was approximately 105%.
- ▶ The average yearly gap between the top and bottom quartile performers was surprisingly consistently around 100%. The data showed no “barbelled” patterns; i.e. +200% one year, and 0% the next.
- ▶ The gap was completely uncorrelated with overall market performance; neither bull nor bear market environments seemed to have any impact on the results.
- ▶ The return differential between the stocks ranked in the second vs. third quartiles has historically been ample enough to gener-

ate alpha without having to expose the portfolio to the risks of owning higher beta stocks. This helps to deliver an attractive balance of risk and reward to the investor.

In the chart on the next page, you can see in the next to last right-hand column that the average inter-sector performance spread between the “slightly better than average” second quartile stocks vs. the “slightly below average” stocks was roughly 22% per year. This too was very consistent year-in and year-out, and the data shows no correlation to the market environment. We believe this differential represents a great opportunity for portfolios constructed with a bottom-up approach, since it appears that it is possible to significantly outperform – with consistency and repeatability – through solid fundamental research in this asset class.

How is the Small Cap Value strategy managed to generate consistent alpha?

Our Small Cap Value strategy is managed around a very simple thesis. We believe that excess returns can be sustained by picking stocks that meet three key characteristics we refer to as the three “rights”:

Right company – Above all, a good management team running a solid franchise marks the right company. By “solid franchise,” we mean a company that holds a strong market position in a relatively

small market. For example, one of our positions in the portfolio has a commanding market share (40%+) for manufacturing equipment used in road construction. Its next largest competitor holds less than a 10% share. Superior market positioning enables the leader to invest in more technology, manufacturing, distribution, and marketing. Thus its market leadership position fortifies the business model.

Another company we hold in the portfolio leads the market in a very specific and costly materials processing technology. It's the industry's top player, and is in the process of acquiring its second largest competitor. This market is largely driven by infrastructure spending. High oil prices have impeded normal capital investment in energy and chemical infrastructures; a new spending cycle is long overdue, which bodes well for the stock.

Right time – The right time to purchase a company, simply put, is when we see evidence that the future looks significantly better than the recent past. The macroeconomic environment does not considerably distract us from our focus, which is held narrowly on what companies are doing to improve their lot in life now. For example, in considering an investment in a consumer product manufacturer, rather than try to time a market entry, we ask: What new products is the company bringing to market? Does the new management team bring some advantage to running the business? Is the company primed to benefit from regulatory changes that will spur demand for its product? Or, is it just the right time in the cycle for them? Macro factors have an impact. But our ultimate investment decision revolves more around the health of the individual company.

Dispersion of Stock Returns Offers Alpha Potential in Small Caps

GICS® Sectors	Average % returns by quartile (2000-2007)					
	1	2	3	4	2-3	1-4
Consumer Discretionary	70.4	15.4	(8.7)	(40.4)	24.0	110.8
Consumer Staples	72.4	20.3	2.2	(30.8)	18.1	103.3
Energy	84.3	34.4	10.6	(21.9)	23.8	106.2
Financials	50.4	18.5	4.9	(19.9)	13.6	70.2
Health Care	78.6	11	(16.1)	(52)	27.1	130.6
Industrials	67.4	20	(2.1)	(34.7)	22.1	102.1
Information Technology	68.6	4.2	(23.4)	(51.8)	27.6	120.4
Materials	74.8	20	(0.4)	(34.2)	20.4	109
Telecomm. Services	89.5	7.8	(26.6)	(57.4)	34.3	146.8
Utilities	43.7	18.7	8.2	(8.6)	10.5	52.3
Average	70	17	-5.1	-35.2	22.2	105.2

Past performance is no guarantee of future results. Source: FactSet

Right price – The right price to buy a stock is when it's selling at a discount to our estimate of its "intrinsic" value. So even what appears to be a relatively expensive stock could receive our careful consideration if it's attractively priced. In general, price relative to the value is of greater interest than traditional valuation metrics like P/E, P/B, or PEG. The one valuation ratio we prominently consider is price to free cash flow, because cash generation ultimately determines value.

Our investment process is designed to be consistent and repeatable. It also ensures that our philosophy is directly reflected in our portfolios.

We've been successful in creating value above the benchmark consistently since the strategy's inception in May 2005. We've achieved this by following the plan I just described, but systematic portfolio construction also plays a role. Our investment process is designed to be consistent and repeatable. It also ensures that our philosophy is directly reflected in our portfolios.

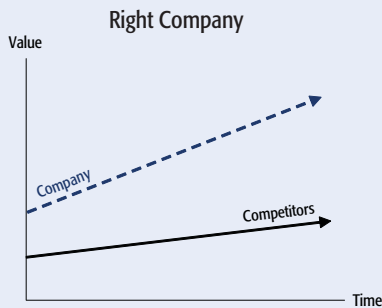
How is your philosophy incorporated into your investment process?

The first step in our process is idea generation. We get investment ideas from any number of sources, but probably our best ones come from company visits. We also look for industry trends that might suggest the "right time" for a group of companies. And we monitor price movements, seeking "right price" opportunities.

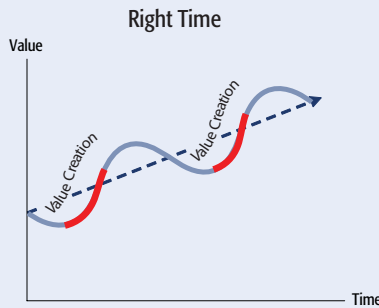
We then run our leads through a scoring model that combines about 30 qualitative and quantitative measures, ranking the opportunities relatively on right company, right time, and right price. The scores are based 1/3 on valuation and 2/3 on fundamentals (company and timing, with company quality outweighing timing 2 to 1). The output is a score of 0, 1, or 2. We conduct further research on the 1s and 2s, and we pass on the 0s. This scoring acts as a gateway into deeper fundamental analysis. It is also a way that we tag issues for further investigation – questions or reservations on a stock that may have passed muster through the initial round.

The short list of attractive candidates that reaches this point undergoes intense fundamental research. This is where we really strive to develop a clear investment thesis that diverges from the market's view in some significant way. We focus on earnings power and on what we believe to be the right multiple we have to pay for future earnings right now. We record our thesis and note important milestones that indicate whether or not we are on track as the story plays out.

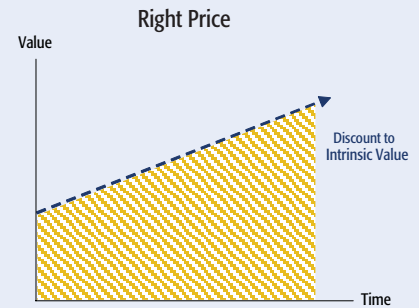
Consistent Investment in the Three “Rights” – A Key to Sustainable Alpha Potential



Our fundamental research tries to identify companies that create value faster than its competitors



The time at which a company creates value is often cyclical. Our research tries to identify if a company's future will be better than its recent past



At times, stocks sell at a discount to the company's intrinsic value, creating a buying opportunity

After prioritizing our opportunity set, conducting research, and finding high-conviction ideas, the remaining source of alpha is in portfolio construction. We're looking not only to reflect an individual stock's potential in the portfolio, but to reap further gains through proper position weighting, and our sell discipline.

This process allows us to run sector weights very close to the benchmark and add value at the stock level. Position sizes may go as high as 5%, but are now topping at 3.5%; we want a well-diversified portfolio.

We are also very diligent about selling. Every week we examine relative price changes of 10% or more. Those that lag are subject to immediate review. Fundamental review of companies is ongoing.

Lastly, quantitative risk management is tremendously important. We tend to detect problems early on, since quant models are backward-looking. But these measures do provide a helpful, objective look at aggregate risk and where risk is helping or hurting returns on a sec-

tor, stock, or factor basis. We make appropriate adjustments if the analysis indicates that our views are not being properly expressed in the portfolio.

Can you tell us about your team?

We have an experienced team that thinks about investing client money in an intelligent and rational way. We're investors at OpCap. And everyone does research. It's not a place where some professionals manage portfolios and others analyze. A research mentality permeates our shop.

Consistency is a big part of what we do, which is why we use the three "rights" as a repeatable template. We pay close attention to risk and maintain the same discipline, regardless of market movements and trends. It's this consistent discipline that has helped us achieve our goals of generating consistent alpha and a high information ratio since the strategy's inception in May 2005.



Value Core Growth Global Fixed Income Alternatives

1345 Avenue of the Americas New York, New York 10105

www.opcap.com

The information presented in this report has been developed internally and/or obtained from sources which Oppenheimer Capital believes to be reliable; however, Oppenheimer Capital does not guarantee the accuracy, adequacy or completeness of such information nor do we guarantee the appropriateness of any strategy referred to for any particular investor. There is no guarantee that any opinion, forecast, estimate or objective will be achieved. This report is provided for informational purposes only and should not be construed as a recommendation for the purchase or sale of any security, or the appropriateness of any strategy for any particular investor. This report reflects the opinion of the commentator(s) on the date made and is subject to change at any time without notice. Past performance is not indicative of future performance. The Global Industry Classification Standard ("GICS®") is the exclusive property and service mark of Morgan Stanley Capital International Inc. and Standard & Poor's, a division of The McGraw-Hill Companies, Inc. No express or implied warranties or representations are made with respect to GICS® of the results obtained by the use thereof, and no party shall have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) with respect to GICS data or results obtained therefrom.