



Philosophy

Fort Washington believes that there are inefficiencies in the small cap growth market. To capitalize on these, we focus on companies that are experiencing improving secular or cyclical fundamental trends, companies that are of high quality and well-managed, and companies with competitive business models.

Process

Fort Washington's Small Cap Growth Equity strategy is based on a disciplined bottom-up process emphasizing stock selection along with consideration of industry exposure. Our stock selection process uses proprietary quantitative ranking tools to provide a "bullpen" of ideas on the best small cap growth securities. Sector specialists focus on companies with improving fundamentals that are favorably positioned to form sustainable competitive advantages within their industries. The target market cap range is \$100 million to \$2.5 billion. Risk is also controlled by limiting sector weights to approximately +/-5% around the Russell 2000 Growth Index.

Investment Professionals

Richard R. Jandrain III

Managing Director
Senior Portfolio Manager
Sector: Technology
33 Years Experience

Daniel J. Kapusta

Senior Portfolio Manager
Sectors: Consumer & Finance
(Brokers & REITs)
23 Years Experience

David K. Robinson, CFA

Senior Portfolio Manager
Sectors: Industrial, Materials, & Energy
24 Years Experience

Bihag N. Patel, CFA

Senior Portfolio Manager
Sectors: Healthcare & Finance
(Insurance & Banks)
12 Years Experience

Performance

The Small Cap Growth portfolio underperformed the Russell 2000 Growth Index by about 1.7% during the fourth quarter. After a pause in October when small cap stocks declined approximately 7%, equity markets resumed their upward move in November and December, rising about 12% for the two month period. Although equities pulled back during most of earnings season, stocks ultimately responded favorably to what turned out to be a positive reporting period. Positive returns for the quarter were a result of four key drivers: positive earnings, continued better-than-expected economic reports both here and abroad, generally strong commodity prices and continued low interest rates.

Factors Contributing to Performance

The portfolio lagged the index this quarter due to a combination of several factors – 1) negative developments in two of our holdings – a technology company that lost a large customer and a healthcare company negatively affected by speculation surrounding reimbursement rates, 2) poor earnings announcements in several companies for a variety of reasons including deteriorating backlog and weaker than expected sales growth, 3) the continuing though moderating theme of the outperformance of lower quality stocks (defined as high debt, high beta, etc.). The financial, energy and consumer discretionary sectors had the most positive relative impact on the portfolio's return in the quarter but were more than offset by poor performance in the healthcare, technology, industrial and materials sectors. Consistent with the prior two quarters, healthcare relative returns were the most detrimental. The more cyclical sectors outperformed, as did speculative biotech companies with pending or announced clinical trial data.

Portfolio Positioning and Outlook

Our portfolio positioning at the end of the fourth quarter is somewhat similar to that of the third quarter with respect to sector weightings. The portfolio's largest overweight is in the energy sector, at about 200 basis points overweight relative to the Russell 2000 Growth Index. Consumer discretionary, financials and technology are also slightly overweight. Our overweight in energy is predicated on the belief that 1) energy demand in general will improve as the global economy rebounds, even if that rebound is much less robust than in past cycles and 2) although current oil inventories are higher than normal, global oil production growth will be challenged. In consumer discretionary, we are positioned in companies that have strong organic top line growth driven by 1) domestic geographic expansion, 2) international growth and/or 3) recurring revenue. Our modest overweight position in financials is driven largely by holdings in pawn brokers and debt collection companies, which should benefit from the continued contraction in consumer credit, higher gold prices and increasing supply of charged-off credit card debt. In technology, we believe the need for increased data capacity in both Internet and wireless applications will benefit many of our holdings. We also believe that valuation levels are still attractive and balance sheets are strong.

The economy has stopped contracting and, because of massive corporate cost saving initiatives put in place a year ago, margins and earnings are rebounding sharply in spite of still less than stellar sales growth. The stock market has taken its cue from economic and earnings improvement, rallying sharply from the March lows. In spite of the recent economic improvement, we believe the business environment will be challenged over the next 1-2 years, which, combined with narrowing valuation spreads, will bring higher quality companies back into favor.

Thus, our focus is on finding companies that have the ability to increase sales even in a difficult economic environment. We will also consider companies that can improve operating margins and generate EPS growth in the absence of top line growth if they provide sustainable margin expansion, strong cash flow metrics and a solid balance sheet.