bounded rationality CONCEPTS

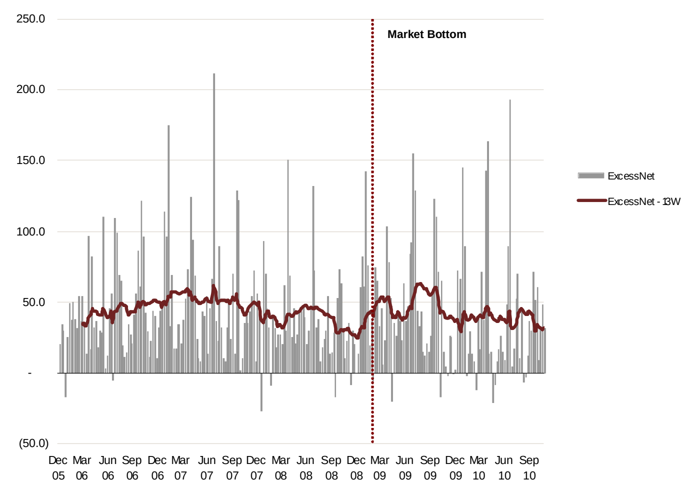
Has the World Really Changed?

November 2010

Our primary investment mission at BRC is to concentrate on two fundamental questions: 1) Are we able to predict the future behavior of security analysts, and 2) How are investors responding to the events that we are trying to predict? With regard to the first question, our behavioral models have performed quite well and relatively consistently both before and after the depths of the financial crisis. Throughout this period, we have been able to consistently construct portfolios of companies with strong fundamentals, accelerating analyst revisions and positive earnings momentum. We have seen however, that since the market bottom in early March 2009, the degree to which investors have cared about individual stock events has declined significantly. While these lower than average response rates have persisted for some time, we do not believe that the world has changed permanently. Instead, we believe that risk perceptions and investor confidence in financial forecasts were dramatically shaken in the wake of the financial crisis and that the unwinding of these effects will take time.

Chart I: Weekly Excess Revisions

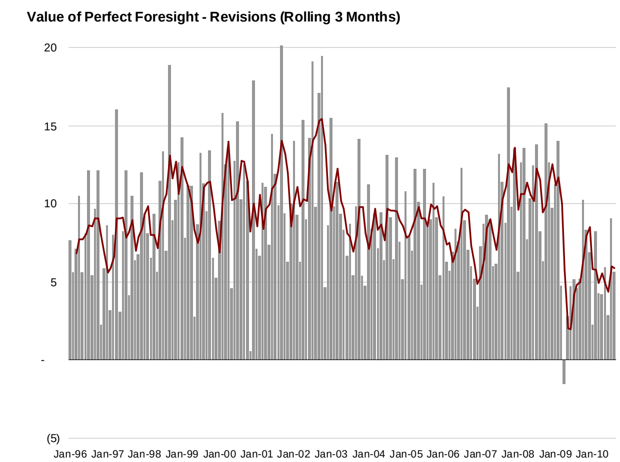
Large Cap Concentrated Equity - Dec 31, 2005 to Nov 27, 2010



Ability to Predict Analyst Behavior Remains Strong

Chart I summarizes the weekly predictive ability of our quantitative models. To assess our proficiency at predicting security analyst behavior, we compare the actual analyst revisions our client portfolios receive to those of a hypothetical random portfolio that is selected from the same investment universe. We have coined the phrase “excess revisions” to refer to the difference between our actual portfolio revisions and those of this hypothetical random portfolio. If our models were unable to predict analyst behavior, the average revision difference between our actual portfolio and that of the random portfolio would be zero. Excess revisions realized by our Large Cap portfolio have remained relatively steady throughout the market crisis. Over the 166 weeks from January 2006 through March 7, 2009, our

Chart II: Value of Perfect Foresight



Large Cap Concentrated Equity portfolio experienced an average of 43.8 excess revisions per week. Over the 90 weeks since March 14, 2009, the portfolio has experienced an average of 42.5 excess revisions per week.

While the ability of our quantitative models to predict security analyst behavior has remained strong, the degree to which investors have cared, or responded, to these analyst pronouncements changed abruptly and significantly in March 2009. Chart II depicts the monthly payoffs to being able to perfectly see into the future with respect to analyst earnings revisions. To produce this analysis, we calculate what the benefit of knowing, at the beginning of each month, which 100 stocks are going to have analyst earnings estimates revised upward and downward the most during the upcoming month. We call the spread between the average return of these two hypothetical portfolios the "Value of Perfect Foresight".

Over the 13-year period from January 1996 through February 2009, the average of our Value to Perfect Foresight measure was approximately 9.6% per month. Since March 2009, not only have we witnessed the first ever negative return to perfect foresight, but the average monthly spread has dropped 52% to only 5.2% per month.

We believe that investors' tepid responses to analyst upward and downward estimate revisions are symptoms of greater structural forces that are driving equity prices and diminishing the impact of active stock selection. We have developed some methods for measuring these forces and have found that, in some cases, the magnitude of these structural abnormalities are the highest we have seen in at least 30 years. It is with respect to these structural forces that we must ask: Has the world changed?

Has the World Changed?
Issue #1: Security Analyst Uncertainty

For over the past year we have been measuring security analyst uncertainty. Using individual analyst estimates for every company in the Frank Russell 1000, we have looked back to 1996 and measured the average dispersion of analyst estimates around their consensus estimates for the current and next fiscal year. We postulate that when dispersion is low, analysts are collectively certain about their future forecasts and when their estimates are highly dispersed, we contend that analysts are relatively uncertain about the course of future events.

On Chart III, we track the weekly and 13-week average of our analyst dispersion calculation for all Frank Russell 1000 stocks. What probably isn't a surprise is that during the heart of the financial crisis, analyst dispersion was nearly 75% higher than the highest level previously recorded. What may be surprising, is that even though the end-of-world scenarios contemplated in the fall of 2008 have dissipated, and analyst uncertainty has declined significantly, the current level of dispersion is still nearly equal to the highest level we have ever measured assuming the chaos immediately surrounding the crisis is excluded.

We believe this high level of dispersion has affected the degree to which investors respond to analyst revisions. If analysts collectively are perceived to be less certain, it seems reasonable that investors might discount the

Chart III: Dispersion of Security Analyst Earnings Estimates

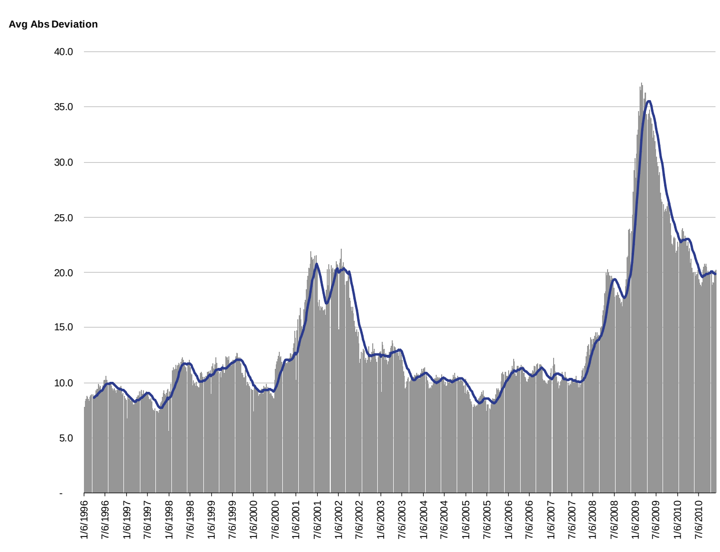
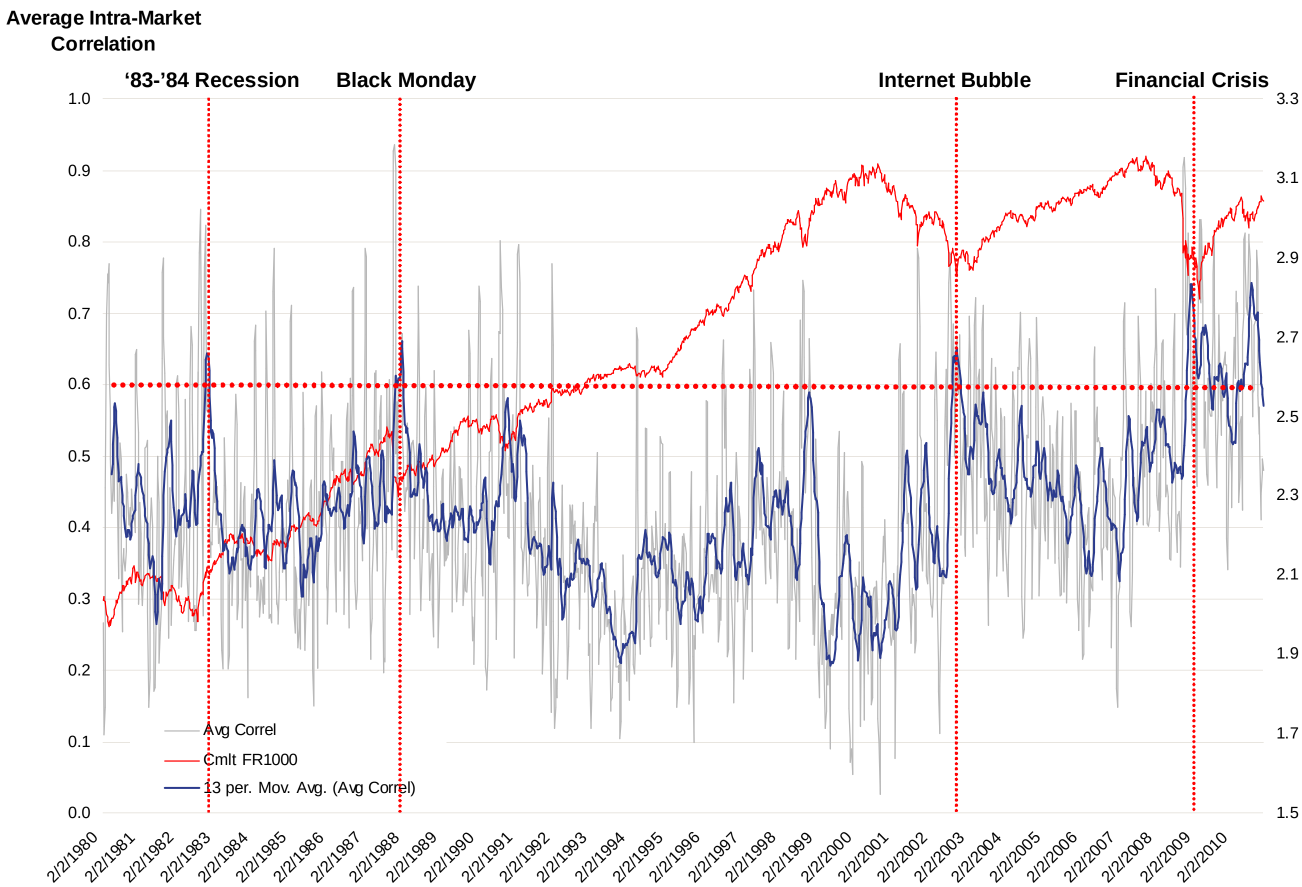


Chart IV: Frank Russell 1000 Intra-Market Correlation—1980 to 2010



value of their forecasts. The decline in our responsiveness measures coincides exactly with the dramatic increase in dispersion we recorded in September 2008.

The important follow-up question to "has the world changed" , is "will this current level of extremely high analyst dispersion be the new normal?" Our view is that the world has not permanently changed. We expect analyst dispersion will slowly decline to more historically normal levels. We believe that current high levels of dispersion are due to the lingering effects of the shock caused by the financial collapse combined with unusually high levels of macroeconomic uncertainty. As always, human behavior will eventually adapt to new market conditions and we expect uncertainty to dissipate over time.

Has the World Changed?
Issue #2: Stock Price Correlation

We believe many of the current challenges seen in the active management universe relate to historically unprecedented levels of intra-market correlation that began at the onset of the financial crisis. The deep recession and the collapse of world-wide equity markets has had many repercussions, but for the money management industry, one of the most important has been the dramatic increase in the correlation of individual stock returns. On Chart IV, we have plotted our calculation of "Intra-Market Correlation" (IMC) back the beginning of 1980. Prior to the financial crisis, there were only three brief time periods where our measure of correlation broke above +0.60 on a rolling 13-week basis: 1) at the end of the 1983/84 recession; 2) during the weeks following Black Monday in October 1987, and 3) during the final stages of the collapse of the internet bubble in the fall of 2002. During all of these periods, our correlation index remained above +0.60 for between 6 and 12 weeks. In contrast, in the current environment, our correlation index first crossed +0.60 during the week ending November 15, 2008 and has been above +0.60 for 74 of the 104 ensuing weeks (72% of post crisis weeks).

We believe this historic level of stock price correlation implies that systematic and macroeconomic factors are

BRC Investment Management LLC

8400 East Prentice Avenue
Suite #1401
Greenwood Village, CO 80111

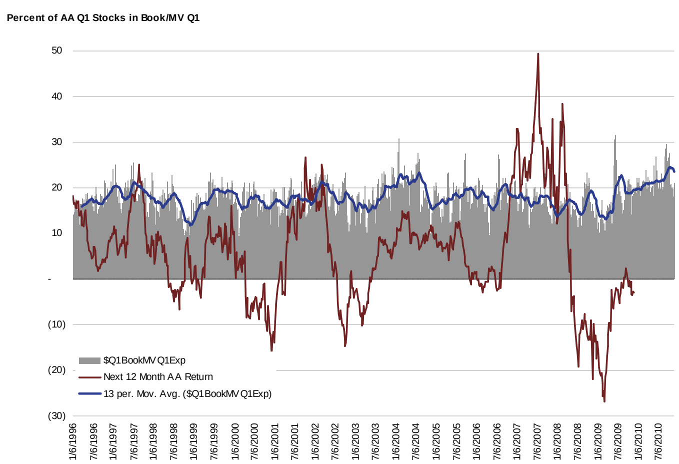
Phone: 303-414-1100
Fax: 303-414-1111
Email: ddurie@brcinvest.com

We are on the web:
www.brcinvest.com

BRC Investment Management LLC offers investment counsel to pension and profit sharing funds, individuals, corporations, endowment funds and foundations. The firm's strategy is to provide personalized investment services to our select clientele and flexibility in ever changing investment markets.

For over 20 years, the investment professionals at BRC have established a reputation for quality investment counsel and exceptional returns. Through the technological and fundamental expertise of our investment team and staff, BRC will strive to maintain its position at the forefront of quantitative, fundamental and behavioral portfolio management techniques.

Chart V: Valuation of Highest Ranked Stocks



dominating individual stock returns. A higher proportion of stock returns attributable to systematic forces implies that stock specific factors have had less influence. We, like many active managers, make our living by identifying stock specific characteristics that have not been fully valued by the market. When stock returns are dominated by systematic and macroeconomic factors, the opportunity for adding value through stock selection diminishes.

We do not believe that high stock price correlation will persist indefinitely. As prices continue to move in concert, valuation differences between strong and weak companies will continue to grow. As a result, stocks our model finds attractive are selling at valuation levels that are equal to the least expensive we have ever measured, as depicted in Chart V. In the past, whenever our highest ranked stocks have become as inexpensive as they now are, future returns to our model have been significantly above average. We think it extremely unlikely that these valuation abnormalities will persist. Eventually, mis-pricings will be discovered by investors and correlations will decline.

Even though the impact of the financial crisis has been profound, we contend that investors will ultimately care again about the relative merits of individual stocks. Uncertainty surrounding the wide array of possible future macroeconomic events will eventually abate and investors' interest and focus should return to the fundamentals of individual companies. As this occurs, we expect the correlation between individual stock returns to decline and the response rates to future analyst estimate revisions will increase toward more historically normal levels.