Cramer Rosenthal McGlynn

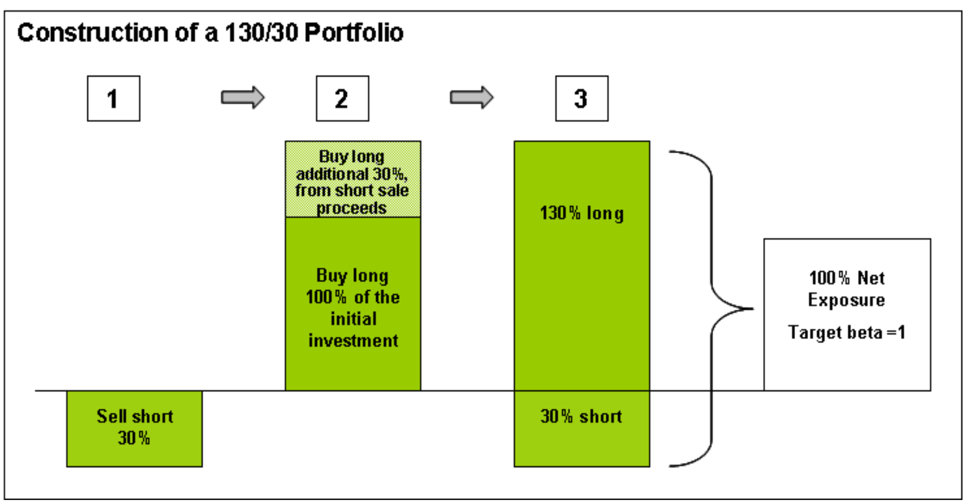
Introduction

The 130/30 approach to equity management is quickly gaining favor among institutional investors. Though broadly available only within the past few years, multiple sources have estimated assets under management in these strategies to already exceed $50 billion.[1] 130/30 strategies are designed to make equity allocations work harder and more efficiently by relieving the long-only constraint on equity managers. In a traditional long-only equity portfolio, if a manager believes a company's share price is overvalued relative to the market, the manager's sole method of expressing his or her conviction would be to avoid purchasing the issue. A 130/30 strategy would afford the manager an opportunity to take a short position in such a company and generate gains if the manager is correct in its assessment.

One recent industry survey finds almost 60% of major U.S. pension plans are either currently using or seriously considering investing in 130/30 strategies.[2] There are a number of arguments in favor of considering a 130/30 strategy over a long only approach. As is the case with any investment decision, careful thought should be given to how the strategy works and how best to realize its potential benefits.

What is a 130/30 Strategy?

A 130/30 strategy is a long/short equity strategy that shorts 30% of the portfolio and invests the proceeds from the shorts along with the initial investment, resulting in a 130% gross long exposure. The value of the long exposure (130%) minus the value of the short exposure (30%) equals approximately the initial investment. In other words, the portfolio has a full 100% net exposure to the market and, as a result, has a target beta of 1 to the market.



1 *FundFire*, March 14, 2007 and *Pension and Investments*, April 16, 2007.

2 JP Morgan Asset Management, *Investment Decisions*, April 2007.

Benefits of Investing in a 130/30 Strategy

- *Ability to generate higher alpha:* Introducing the ability to short in the portfolio provides an opportunity to 130/30 managers to improve their expected alpha by investing in compelling opportunities and shorting unattractive investments.

- *More efficient use of research:* 130/30 managers are given an opportunity to fully leverage their investment insights into unattractive, as well as attractive stocks, in seeking to maximize returns.

- *Shorting enhances risk management:* 130/30 managers can simultaneously short to hedge against market risks, providing a vital risk management tool that can protect returns.

- *130/30 remains within the traditional equity allocation:* A 130/30 portfolio fits within the traditional equity allocation as the portfolio has full exposure to the market.

Risks of Investing in a 130/30 Strategy

- *130/30 strategies are relatively new to the market:* Although the concept of 130/30 and other relaxed constraint strategies (e.g., 120/20, 140/40 and 150/50) has been researched for more than a decade, the strategy began to gain traction over the last few years as investors grew more comfortable with alternative investments and their demand for alpha increased. Investors looking to invest in 130/30 strategies may need to evaluate 130/30 managers based on a limited or no track record in the strategy in order to determine whether the manager has the skills to successfully leverage prior experience in traditional and long/short investing to this relatively new strategy.

- *Many traditional investment managers lack experience in shorting:* Short selling is not merely the reverse of traditional investing. The ability to source short ideas and enhance excess returns through shorting, the primary value proposition of 130/30 strategies, requires a disciplined process that many traditional managers have not developed as new entrants to long/short investing. Short selling also requires experience in managing additional trading issues related to borrowing costs and securing stocks to borrow as well as managing liquidity in the portfolio to efficiently close out positions.

- *130/30 managers can generate unlimited losses in short positions:* A short position in a stock has a different risk profile from that of a long position. In theory, there is no limit to how high the price of a stock that has been shorted can rise so the potential loss on such a short position is theoretically unlimited. Short portfolios require strict risk management policies to manage losses. Managers with comprehensive risk management processes at the portfolio and position level can limit losses in short positions.

- *Special tax issues may apply to a 130/30 strategy*: A manager's investment decisions may be affected by Unrelated Business Taxable Income ("UBTI") issues that impact tax exempt investors. Taxable events may be generated within a 130/30 strategy, either from the use of certain forms of leverage deemed "acquisition indebtedness" or from certain securities held in the portfolio. A well-informed, tax-aware manager can generally avoid creating such issues.

CRM 130/30 Value Strategy

Investment objective
The CRM 130/30 Value strategy is a bottom up strategy that will generally invest in companies with market capitalizations greater than $1 billion. Over a full market cycle, the 130/30 strategy seeks to generate an annualized excess return of approximately 2%, net of fees, above the Russell 1000 Index.

Investment process
CRM has historically generated excess returns in its long only equity strategies, including, since its inception nearly three years ago, the Large Cap Opportunity strategy. Ideas for these strategies are all generated by the same investment team. In the 130/30 strategy, the long portion of the portfolio generally will be invested according to the same investment process used to manage all of the firm's strategies. The ability to short will enable us to express a negative opinion based upon the research we conduct on the stock. The short portion of the 130/30 portfolios will consist of both short positions that are established to enhance expected excess returns by capitalizing on negative opinion as well as shorts that are established to hedge certain specific or market risks to protect excess returns.

CRM seeks to manage a portfolio that has an average exposure of 130% long and 30% short and a maximum allowable exposure of 135% long and 35% short, providing us the ability to preserve capital in some markets. The long portfolio will have approximately 45-55 securities similar to the firm's other equity strategies. The number of short positions will vary depending on opportunities and market conditions, but will generally be diversified across 35-50 securities. CRM will primarily invest in U.S. equities and ADRs. In the short portfolio, CRM will also use ETFs as a convenient method of shorting specific sub-sector exposures.

Why Invest in the CRM 130/30 Value Strategy Now?

CRM has successfully generated annualized excess returns across its institutional small, small/mid, mid and all cap strategies with each strategy. The long portion of the CRM 130/30 Value strategy will invest in a similar fashion to the CRM Large Cap Opportunity strategy, leveraging ideas across all of the firm's investments primarily in the mid to large cap market cap range.

As a firm, we have been managing long/short equities for over a decade and have the experience to identify attractive and unattractive stocks across a broad range of companies. We have both the experience, as well as the infrastructure, to manage a 130/30 portfolio. As a result, the trading and operational complexities of managing a 130/30 strategy is not new to us. We have a long standing relationship with our prime brokers, which will well position us to efficiently borrow the stocks to short at reasonable costs and we review liquidity in the portfolio on a regular basis. CRM also has comprehensive risk management systems in our long/short equity strategy, which currently has $150 million in assets, to manage losses. In addition, we use ETFs, which are also relevant for the 130/30 strategy, as a convenient and cost effective way to hedge specific sub-sector risk. We do not plan to short index ETFs in the 130/30 strategy, but will rather rely on sector and customized ETFs to hedge specific risks in the portfolio.

Our portfolio managers review position attribution and sector exposures on a regular basis to monitor where the risks in our long/short equity portfolios lie and to limit potential losses in both the long and short portions of the portfolios. In the long/short equity strategy, we have maintained our average net exposure consistently between 40-60% and our stock selection has been the primary driver of performance.

Conclusion

We believe 130/30 strategies provide an alternative way to enhance alpha within the context of a traditional long only equity allocation. The U.S. equity markets have enjoyed strong performance over the last five years. As volatility has reverted to historical normal levels, we believe the ability to short in a 130/30 framework will enable us to take advantage of more opportunities. As investors we look for opportunities where the sum of the parts is more valuable than the whole. Similarly, the CRM 130/30 Value strategy seeks to combine our proven track record in the firm's traditional investments and our experience in shorting to create a diversified portfolio that targets a higher alpha in various markets.