

3 October 2007

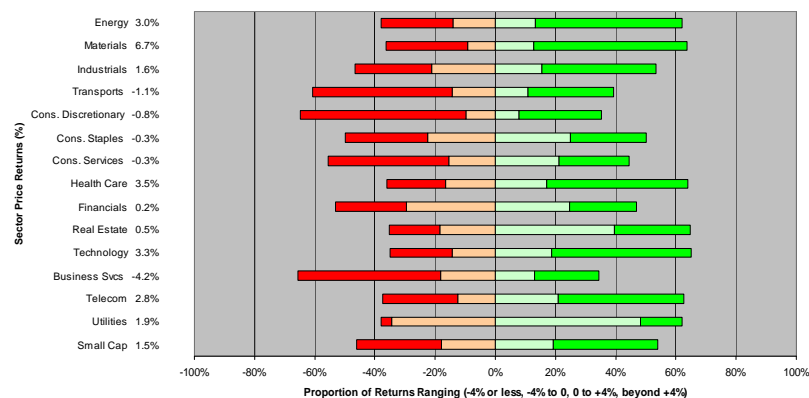
# Briefing: Small Cap

The debacle of August seems far away when looking at September results. The 50-basis-point cut in Fed Funds rate appeared to ignite the market and a taste for equities. Notwithstanding a cautious return of risk appetite, the equity market favored the S&P 500 (+3.6%) over the Russell 2000 index (+1.6). Lower capitalization and less liquid strategies as a whole sharply underperformed.

## Highlights

- **Curious crosscurrents emerged as the market appeared to embrace risk, but shun smaller, less liquid ideas.** Credit trends have begun to reverse quietly. This is coincident to other metrics that suggest that risk appetites stabilize. To date, lower quality bond spreads have pulled in by 60 basis points from their August peaks.
- **Leadership appears back among the IME (Industrials, Materials and Energy).** Factors such as momentum or relative price strength and earnings revisions characteristics appeared to recover nicely. Read as: quantitative growth factors are working. That said, classic valuation metrics continue to break. A higher multiple bias appears the order of the day.
- **Risk appetites seem to be back.** Riskier equity strategies appear to have reversed as credit spreads have narrowed. Quality and growth strategies outperformed; stocks with higher credit quality bonds underperformed lower quality by 70 bps.

Fig 1: September Sector Results with Dispersion of Returns



Source: Cirrus Research

## Supporting Exhibits

- Sector Dispersion of Returns, pg 1
- Factor Analysis and Exposure in Sector, pg 2
- Top and Bottom Performing Stocks and Industries, pg 3

## Market Measure

	Total Return %	
	Sept	YTD
Cirrus Small Cap Index	1.6	4.6
S&P 500	3.7	9.1
S&P MidCap	2.6	11.0
Russell 2000	1.7	3.2
NASDAQ Composite	5.7	12.3
T-10 Yr Yield	0.8	-2.8
T-Bill Yield	-2.8	-18.7
Euro	4.3	7.8
Yen	0.8	3.6
Crude	10.3	33.8
Gold	10.4	16.9

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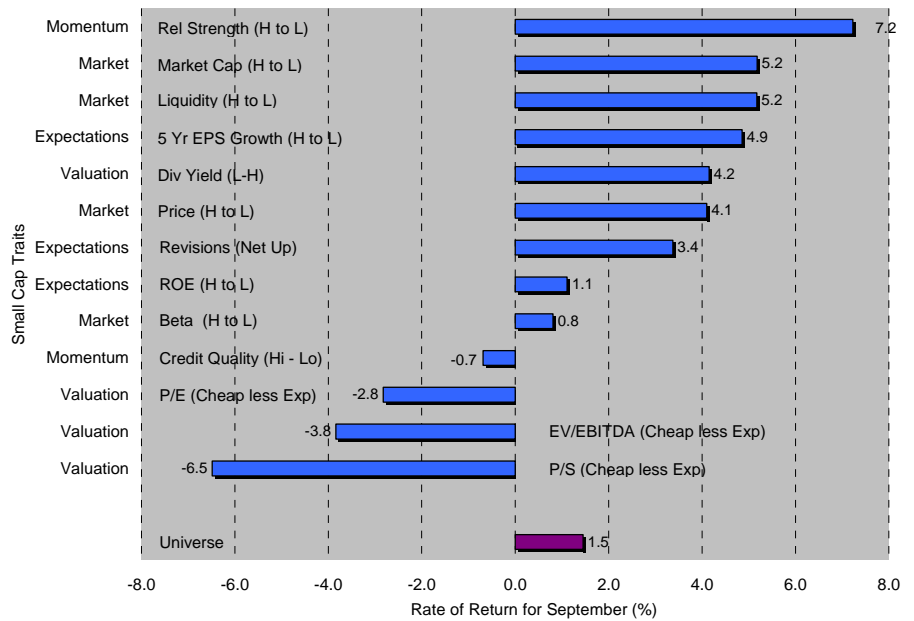
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Aside from the strong performance of the Materials (6.7%) and Energy (+3%), the growth wave boosted Technology (+3.5%) and Health Care (3.4%).

Transports (-1.1%) and Business Services (-4.2%) suffered as rising fuel costs and declining confidence about the economy took their toll.

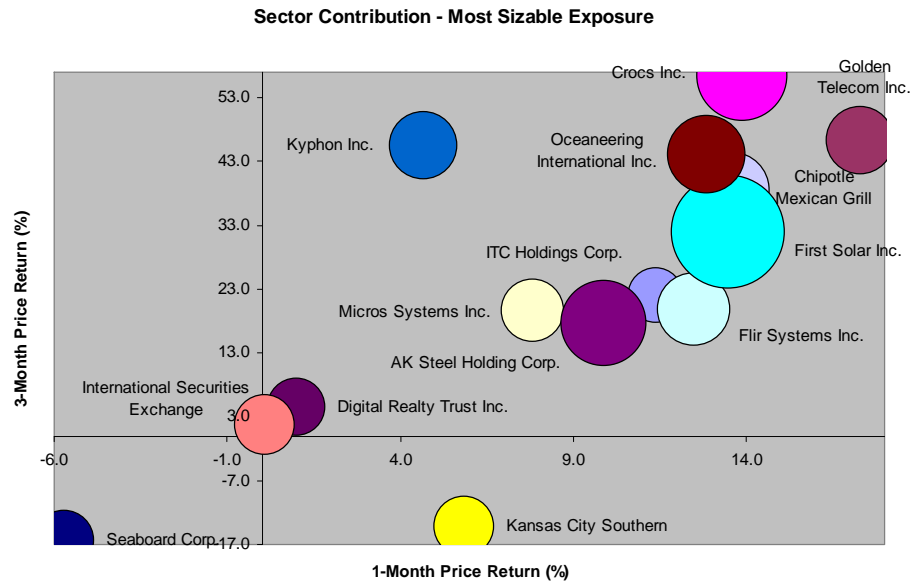
Fig 2: Factor Behavior – Small Caps



Source: Cirrus Research

Fig 3: Significant Exposure within Sector; 1-Mo vs. 3-Mo Price Returns

Recent star stocks Crocs, First Solar and Chipotle didn't show any signs of tiring.



Note: The size of the bubble represents the market capitalization scaled against each sector's sizable firm. The location of the bubble represents the one-month rate of return (x-axis) versus the three-month results (y-axis).

Source: Cirrus Research

Banks continued to benefit from M&A activity. ALAB was bought by Royal Bank of Canada. Subsequent to month-end, Commerce Bancorp announced a sale to Toronto Dominion.

#### Small Cap: Best and Worst Performing Industries in September

	% CHG
Gold & Precious Metals	14.0
Diversified Chemicals	13.7
Steel	12.0
Internet Retail	11.2
Catalog Retail*	9.9
Household Appliances*	-14.7
Department Stores*	-15.2
General Merchandise Stores*	-16.2
Homebuilding	-19.2
Distributors*	-28.5

\* Small sample.

## Small Cap Stocks – Best and Worst Performers in September

Top 5 Stocks*		% CHG	Bottom 5 Stocks*		% CHG
ALAB	Alabama Natl BanCorp	47.7	VG	Vonage Holdings Corp.	-51.2
ALNY	Alnylam Pharmaceuticals	40.2	SPF	Standard Pacific Corp.	-45.3
COMS	3Com Corp.	31.7	TOA	TOUSA Inc.	-40.6
GSS	Golden Star Resources	31.1	KKD	Krispy Kreme Doughnuts	-39.8
OPTM	Optium Corp.	30.6	WCI	WCI Communities	-35.7

\* Excludes American Home Mtge and Delphi Corp.

Source: Cirrus Research

## Cirrus Sector Performance: Small Cap Stocks

At 28 September	Price Performance % Change				
	1 Mo	3 Mo	6 Mo	12 Mo	YTD
Energy	3.0	-5.3	7.0	22.1	13.5
Materials	6.7	2.5	12.6	48.1	25.9
Industrials	1.6	0.0	16.7	36.2	22.1
Transport	-1.1	-7.5	-4.3	12.2	4.0
Consumer Discretionary	-0.8	-12.0	-9.9	-1.1	-9.6
Consumer Staples	-0.3	-1.7	1.9	21.0	9.1
Consumer Services	-0.3	-6.2	-4.5	9.3	-0.9
Health Care	3.5	4.3	6.9	17.8	9.7
Financial	0.2	-5.4	-5.8	-7.2	-11.0
Real Estate	0.5	-7.8	-13.6	-10.6	-16.3
Technology	3.3	-1.1	6.5	18.2	9.9
Business Services	-4.2	-8.0	-3.8	9.3	-1.8
Telecommunications	2.8	-1.9	5.3	7.0	1.3
Utilities	1.9	-0.2	-5.8	2.8	-6.1

Source: Cirrus Research

## Small Cap Benchmarks

At 28 September	Price Performance % Change				
	1 Mo	3 Mo	6 Mo	12 Mo	YTD
Cirrus Small Cap Index	1.5	-3.5	1.1	12.1	3.2
S&P SmallCap	1.4	-2.1	2.8	13.9	5.9
<i>Growth</i>	2.8	1.3	7.6	20.4	12.3
<i>Value</i>	0.3	-4.7	-0.7	10.0	1.5
Russell 2000	1.6	-3.4	0.6	11.0	2.3
<i>Growth</i>	2.9	-0.1	6.4	18.3	8.9
<i>Value</i>	0.2	-6.7	-5.0	4.1	-4.0

Source: Cirrus Research

Growth continues to outperform YTD. September widened the distance to almost 1100bps on the S&P while Russell Growth is outperforming Russell Value by a dramatic 1300 bps.

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### Cirrus Benchmarks

Asset Class	Market Cap Range
Nano Cap	\$10 mn - \$100 mn
Micro Cap	\$100 mn - \$600 mn
Small Cap	\$600 mn - \$2.4 bn
Mid Cap	\$2.4 bn - \$10 bn
Large Cap	>\$10 bn

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