THE BOSTON COMPANY

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US Mid Cap Disciplined Growth Equity Management
First Quarter 2008 Investment Commentary

Investment Environment

The first quarter of 2008 witnessed an acceleration of the economic problems lingering from 2007 and clear indications of severe stresses in the US financial system. The US dollar, which struggled against the euro last year, experienced significant weakness against all major currencies during the March quarter. Credit and valuation problems in the sub-prime mortgage area produced far-reaching effects throughout the financial system world-wide, and cast a pall over the US and global equity markets in general. Write-offs at commercial banks, insurance companies and investment banks increased significantly as several financial institutions were forced to seek additional capital, most notably by turning to sovereign wealth funds. Eroding confidence and solvency questions caused the credit markets to demand higher spreads over Treasuries, caused selected markets (auction rate notes) to "freeze up", and assisted in the near bankruptcy of Bear Stearns, which buckled under the weight of a modern day version of a "run on the bank", forcing a hastily negotiated (and Federal Reserve brokered) fire sale to JP Morgan Chase. The restrictive credit environment, higher energy costs and declining home values dampened consumer spending during the period. The current slowdown in consumer spending, which accounts for two-thirds of US GDP, has placed heavy downward pressure on corporate profits and the broader economy. Commodities continued to soar, with soft commodities such as corn, soybeans, and wheat all reaching record prices during the first quarter, as did hard commodities such as oil and gold, although each has pulled back since.

The difficult credit markets and economic slowdown had an overwhelmingly negative influence on equity markets. All of the broad US Equity indices fell during the quarter, with no safe haven across market capitalizations. The small-cap oriented Russell 2000 Index fell 9.9%, the Russell Mid Cap Index dropped 10.0% and the large-cap oriented S&P 500 declined 9.9%, its worst quarter in over five years. In this challenging environment, value stocks outperformed growth stocks across the spectrum of small-, mid- and large-capitalization stocks. From a sector standpoint, nine of ten economic sectors in the Russell 2000 Index had negative returns (only the Energy sector showed a small gain) and all ten sectors of the Russell Mid Cap Index and the Russell 100 Index produced negative returns. On the positive side, both the Federal Reserve and Federal Government have acted with unprecedented quickness to provide monetary and fiscal stimulus to blunt the effects of the downturn. Over the last three months, the Federal Reserve lowered the Federal Funds target rate by 200 basis points and implied a willingness to go lower if needed. Washington has just enacted a fiscal stimulus plan in excess of $160 billion that will attempt to rejuvenate consumer spending through the use of a direct payment of up to $600 per qualified individual. While the benefits of the actions remain to be seen, the speed at which the actions have been taken is heartening. Also benefiting the economy has been the growth in exports. The broad weakness of the dollar has created meaningful cost and pricing advantages for companies with domestic production and dollar pricing.

Portfolio Performance Review

US Mid Capitalization Disciplined Growth Equity strategy underperformed its benchmark, the Russell Midcap Growth Index, during the quarter (based on net-of-fees performance). The continued downward pressure of the broad decline throughout US equity markets especially hurt a number of companies in the portfolio, despite solid earnings fundamentals. In this environment, investors appear to be focused on the very short-term earnings landscape, and seem unwilling to look further out as a lack of confidence in the overall economy has shortened their horizon.

Sector Review

The portfolio was positively impacted during the quarter by exposure to the Utilities and Consumer Discretionary sectors and a lack of exposure to the Telecommunication Services sector. Within Utilities, the portfolio's sole exposure in a natural gas-focused energy company rose on strong fourth quarter earnings and a higher 2008 profit expectation. The portfolio's Consumer Discretionary exposure benefited from stronger relative investments in the restaurant and consumer services segments. In addition, a lack of exposure to the worst performing benchmark sector,

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Telecommunications Services, also helped relative performance.

Conversely, the portfolio was most negatively impacted by investments in the Financials, Information Technology, Industrials, and Materials sectors. The portfolio's focus on capital markets and diversified financial services, which was a driver of performance in previous periods, hurt the portfolio as investor focus on brokerages and counter-party risk in light of the near collapse of Bear Stearns pressured any stocks that even resembled such. One such holding in the portfolio, a New York-based inter-dealer broker specializing in over-the-counter derivatives products and related securities, was down sharply on market concerns that it could face a similar trading loss to the one MF Global reported. Despite the company's reassurance that it is not a Futures Commission Merchant and does not act as a clearing member for futures contracts for retail accounts, shares remained under pressure through the quarter and we eliminated the position.

Within Information Technology, electronic equipment, communications equipment and IT services pressured returns the most. An investment in a company that develops and delivers products and technologies that improve the entertainment experience declined as weaker consumer demand and slowing personal computer sales led to perceptions that they would be affected, despite the company's raising guidance during the quarter. As we manage with a longer-term horizon, we believe this is the best-in-class franchise despite the near-term cautious outlook the company faces. Another investment in an international communications and information technology company serving government and commercial markets fell as the company guided toward the low end of their 2008 estimates. However, fundamentals remain strong and later during the quarter the company guided 2009 estimates above expectations.

Within Industrials, the aerospace and defense segment performed poorly and was the biggest detractor, as several holdings with exposure to Boeing declined on news of further delays to the 787 program.

Looking Forward

As we move through 2008, we anticipate continued high volatility. We expect the market will be challenged by many of the current issues and could experience new challenges, such as rising unemployment as companies seek to reduce costs as well as inflationary pressure in light of rising prices. However, the market should begin to discount the benefits of the fiscal and monetary stimulus, a pending recovery in corporate profits and improvement in investor sentiment. We expect the continued volatility will create several outstanding investment opportunities and are confident our investment process will capitalize in this environment.

In the Information Technology sector, we are overweight relative to the benchmark. Our emphasis is focused on companies that have low technological obsolescence risk, a strong product or servicing position, and are priced at an attractive valuation relative to their earnings capability. We remain diversified across the sector and continue to believe that as companies move toward higher capacity utilization and face slowing productivity growth, an emerging upgrade cycle will drive increased demand for technology related products and services. Further declines in a difficult first quarter offer deeper compelling valuations relative to their growth, and share prices could rise as industry fundamentals improve. While not specifically broad-based, we have focused on a number of companies in the sector that have solid prospects for strong earnings growth. Our larger exposures remain within the semiconductor, software, and electronic equipment and instruments segments.

While the Healthcare sector remains a fertile area of investment opportunity for the portfolio, we are underweight the group. With the 2008 Presidential Election looming, investors will be very sensitive to the change in administration, and healthcare investing will likely be a challenge, given the importance of government policy to overall spending for health care products and services. With that said, this sector should be less impacted by the slowing US economy and benefit from the broader themes that can continue to drive growth: the aging of the baby boomer population, improved patient care, and reduced overall healthcare expenditures for the government, providers, and patients. We continue to believe that within biotechnology, mergers and acquisition (M&A) activity may continue to increase as larger biotech companies seek to fill pipeline gaps. Product in-licensing could outnumber outright acquisitions. We should also see continued strong cash generation, with share repurchases serving as a significant backdrop for most companies in 2008.

We continue to overweight in the Financials sector as we continue to believe that capital markets and diversified financial services segments offer compelling growth opportunities. Despite the near collapse of Bear Stearns and ensuing investor diligence on counter-party risk and transactions, we believe that the segment offers a strong case for capitalizing on the volatility in global markets. We remain concerned about the banking sector overall. Balance sheet growth is slowing, deposit pricing remains competitive, and relative and absolute valuations remain stretched despite weakening fundamentals and lowered earnings expectations. The broader implication continues to focus on the impairment of capital and a substantial impact on the economy as credit availability remains tight. Selectivity remains the best strategy in this environment, especially until clarity emerges on the credit front. However, with the decline in the Fed Funds rate, funding costs have begun to improve and the yield curve has become more favorable. We do not have exposure to the area, but we are encouraged to see the first building block to a fundamental recovery being put into place.

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While the Industrials sector constitutes a wide-ranging group of unrelated industries that offer a variety of investment options, this sector is most susceptible to the slowing economy. We have identified several areas we believe should be able to grow despite a potential slowdown. Aerospace and defense comprise the largest concentration of holdings, but additional positions are held across commercial services and supplies, machinery, and air freight and logistics. We view many of our companies as well positioned for the eventual recovery in US economic growth. As we indicated last quarter, many end-markets are currently healthy. The agricultural sector is experiencing rapid growth because of a worldwide boom in bio-fuels and a growing world population demanding higher-protein diets. The added demand for grains and oilseeds has dramatically increased the prices of agriculture commodities such as corn, soybeans, wheat, and palm oil (which all hit new highs for prices during the first quarter). With higher prices and greater demand for agriculture production, farmers and their suppliers around the world continue to experience the "perfect storm" that is giving them pricing power for the first time in decades.

While maintaining a generally cautious approach to the Consumer Discretionary sector, we have recently increased exposure here. Specialty retailing has presented a number of opportunities and we are now in-line within the segment based on improving earnings and historically low valuations. We also have exposure to the restaurant/leisure, Internet/catalog retail, and apparel/luxury goods segments. While rising energy costs, more broad based inflation, and declining home values are obstacles for the consumer in this environment, we have found selective opportunities that have been able to grow earnings despite the broader slowdown. These opportunities can further benefit when the overall sector begins to recover and potentially offer leadership among their groups.

Our exposure in the Energy sector is concentrated in equipment and suppliers. We continue to experience robust demand for oilfield services worldwide. High energy prices appear less short-term in nature and more like a sustainable trend. As evidence supporting a long business cycle accumulates, these companies usually begin to consider how to position themselves more aggressively. Increasingly, they want to take advantage of the near-term window of opportunity to make strategic investments and acquisitions.