Cambiar Market Commentary: Large Cap Value & Small Cap Value

Cambiar Investors

Overview

The equity markets (as noted by the S&P 500) moved higher in the third quarter, with the S&P 500 posting a 15.6% return – the strongest quarterly gain since the 4th quarter of 1998. The markets were buoyed by rising investor confidence that an economic recovery was indeed under way, thereby increasing the relative attractiveness of equities. Additional positive surprises included a successful cash-for-clunkers campaign, an uptick in home sales and a flurry of corporate M&A activity.

Up to this point, the upward trajectory in equity prices has been fairly indiscriminate. An outsized portion of the market's approximate 60% move off of the March 6th bottom can be broadly attributed to a decline in equity risk premiums (and therefore an expansion in P/E multiples). Going forward, it is Cambiar's view that there will be greater differentiation among stock performance; such differentiation will be a function of fundamentals and earnings.

Skeptics of the market rally have pointed to the preponderance of earnings 'beats' due to tighter cost controls, vs. top-line growth. While this higher earnings via fiscal discipline scenario may be applicable to some of Cambiar's holdings, we also own a number of companies that are experiencing first derivative revenue growth. These companies represent a wide swath of industries, from Healthcare to Energy to Technology. The increased emphasis on company-specific fundamentals should provide a continuing tailwind to Cambiar's research-driven investment approach.

Cambiar Large Cap Value Portfolio Review

The Cambiar Large Cap Value portfolio gained 18.1% (18.0% net) in the third quarter, vs. 18.2% for the Russell 1000 Value Index, and 15.6% for the S&P 500. The Cambiar LCV strategy continues to outperform both benchmarks over the trailing one year, as well as over longer rolling-year timeframes.

Increased liquidity provided strong performance momentum in the more leveraged sectors in the value benchmark; examples include Industrials, Consumer Discretionary and Financials. It is also possible that these sectors benefited from some bottom-fishing, as all three were among the hardest-hit during the market downturn. Although Cambiar's aggregate holdings in Financials and Industrials outperformed those of the benchmark, an underweight allocation to both of these sectors overshadowed the portfolio's strong security selection.

Within Financials, Cambiar initiated a position in a custodial bank, our first ownership of a bank since 4Q07. Up to this point, the portfolio's exposure within Financials has been limited to property/casualty insurance, asset management and an insurance broker. While recognizing that bank stocks typically outperform the market coming out of a down credit cycle, we believe the recovery in bank stocks will be more subdued this time around. Headwinds to earnings include continued credit losses, increased capital requirements, and reduced growth opportunities as a result of a protracted consumer de-leveraging process. We also believe that given the moves in bank stocks, valuations appear to fully reflect the potential earnings recovery, which in our view will not occur until the 2011/2012 time frame.

Cambiar's Energy holdings once again provided the largest value-add for the quarter. Although oil prices have more than doubled this year (from $34 in January to a high of $74 in August), performance for many of the underlying stocks in the index have been muted over this timeframe. Cambiar has benefited from its more diversified exposure in Energy; in addition to our heavyweight integrated oil company positions, the portfolio also has ownership in oilfield services, exploration and production, and alternative (coal) industries. Examples include Chevron, Halliburton, Anadarko Petroleum and Peabody Energy.

Technology was a positive contributor during the quarter. One of Cambiar's theses in Tech is that the demand environment within the sector has shifted beyond an inventory restocking situation to more of a sustained recovery. This scenario is one that is not fully reflected in sell-side expectations, and could result in material revaluations for many of Cambiar's holdings.

In a recurring trend from the second quarter, safe-haven sectors such as Telecoms, Utilities and Consumer Staples were again laggards during the quarter. While

Cambiar's absence in Telecom and low exposure to Utilities were positive contributors to performance, the portfolio's overweighting in Consumer Staples produced a small drag on the portfolios' return vs. the benchmark.

Cambiar Small Cap Value Portfolio Review

The Cambiar Small Cap Value portfolio gained 20.5% (20.3% net) for the third quarter, vs. a return of 22.7% for the Russell 2000 Value Index, and 19.3% for the Russell 2000 Index. As the Small Cap Value separate account nears its 5-year mark (product was launched Nov. 30, 2004), we are proud of the top-quartile* track record that we have compiled for this strategy since inception.

With the exception of Utilities, every sector of the value benchmark posted double-digit returns for the quarter, illustrating the broad-based nature of the rally. As it pertains to the Cambiar SCV portfolio, 49 out of 57 stocks that Cambiar held over the course of the third quarter registered a positive return.

At the sector level, Materials and Consumer Discretionary were the top performers in the index (Ru2000V). Cambiar's performance shortfall relative to the benchmark can be primarily attributed to a lower allocation to these sectors, as well as our stock performance within the sectors. Given the large percentage of lower quality, highly leveraged companies that exist within the Materials complex, it should be expected that Cambiar will not participate in size with regards to this sector. And although Cambiar's Consumer Discretionary positions have been a source of outperformance in past quarters, they were unable to keep pace with the benchmark in 3Q.

While Cambiar's absence in Utilities was a positive contributor to performance, the portfolio's overweight allocation to Healthcare and Consumer Staples were a drag on performance, as these two sectors lagged on a relative basis in the quarter.

As it has been throughout 2009, the Energy sector was again a bright spot for the Cambiar SCV portfolio. Although Cambiar's active decision to overweight Energy was a positive contributor, it was stock selection within the sector that provided the bulk of the value-add. Cambiar's aggregate Energy positions posted a 45% return in 3Q, vs. 29% for the benchmark.

Financials were another positive for the Cambiar SCV portfolio. While large cap banks appear to have been let out of the market's penalty box, concerns remain for the smaller cap regional banks. Cambiar has continued to shun small cap banks due to the potential for higher loan losses, and has instead favored the more predictable earnings outlook in various insurance/reinsurance franchises.

Despite achieving strong gains from the majority of Technology positions, Cambiar's holdings in this sector lagged the index, and thus was a detractor from performance for the quarter. The portfolio's Industrials holdings were also a modest performance drag in the quarter.

Looking Ahead

While there are no shortages of concerns as we enter the final quarter of 2009, it has become increasingly evident that the U.S. economy is on the mend, and poised to move from contraction to expansion. If there has been any surprise to investors, it is that the recovery is occurring more quickly, and at a greater magnitude, than many expected.

Although Cambiar remains cautiously optimistic on the outlook for equities, we also do not believe the market will continue to move up in a straight line, as has been the case for much of the past two quarters. The path of an early cycle recovery is a bumpy one; unemployment, depressed real estate prices and the exit from a massive monetary stimulus plan are very real issues that must still be overcome. As such, the markets will likely bounce back and forth between periods of optimism and pessimism.

While cognizant of the ongoing challenges that face the market, Cambiar also has identified some key supports for equity investors. Such supports include a strong global economic recovery, excessively pessimistic consensus expectations, sustained declines in risk premiums, and an impending sharp recovery in corporate profitability.

As always, we appreciate your continued confidence in Cambiar Investors.

The performance information depicted above represents the Cambiar Large Cap Value (Institutional) Composite. Returns are net of transaction costs and include the reinvestment of all income. Gross returns do not reflect the deduction of management fees. Actual returns will be reduced by management fees. The client is referred to Cambiar's Part II of Form ADV for a full disclosure of the fee schedule. As fees are deducted quarterly, compounding increases the impact of the fees by an amount directly related to the gross account performance. For example, an investment of $10,000 on 1/1/2008 would have resulted in $6,193 on a gross of fees basis and $6,167 on a net of fees basis at 12/31/2008 based upon the actual returns earned in the Cambiar Large Cap Value Composite (Institutional). The Russell 1000 Value Index is a market capitalization weighted index which contains securities from the Russell 1000 Index with a less than average growth orientation. The S&P 500 Index is shown to reflect general market conditions. The S&P 500 is a market capitalization-weighted index of 500 publicly traded stocks. Both the S&P 500 and the Russell 1000 Value Index are broadly based indices which reflect the overall market performance and comparisons may not reflect Cambiar's performance as compared to the performance of other investment advisors. These stock indexes assume reinvestment of dividends and capital gains, and assume no management, custody, transaction or other expenses. Cambiar's past results do not necessarily indicate Cambiar's future performance and, as is the case with all investment advisors who concentrate on equity investments, Cambiar's future performance may result in a loss.

The performance information depicted above represents Cambiar's Small Cap Value Composite. Returns are net of transaction costs and include the reinvestment of all income. Gross returns do not reflect the deduction of management fees. Actual returns will be reduced by management fees. The client is referred to Cambiar's Part II of Form ADV for a full disclosure of the fee schedule. As fees are deducted quarterly, compounding increases the impact of the fees by an amount directly related to the gross account performance. For example, an investment of $10,000 on 01/01/2008 would have grown to $6,441 on a gross-of-fees basis and $6,365 on a net-of-fees basis on 12/31/2008 based upon the actual returns earned in the composite. The performance of the Russell 2000 Value benchmark and the Russell 2000 shown above include the reinvestment of all income. The Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. Cambiar's past results do not necessarily indicate Cambiar's future performance and, as is the case with all investment advisors who concentrate on equity investments, Cambiar's future performance may result in a loss. Please refer to Appendix A of this presentation for a detailed explanation of performance.

* Source: eVestment Alliance