ACM

AVOCET

CAPITAL MANAGEMENT

QUARTERLY INVESTMENT REVIEW

First Quarter 2011

1. Markets Overview
2. US Stocks
3. Non-US Stocks
4. Bonds
5. Real Estate Investment Trusts (REITs)

MARKETS OVERVIEW

First Quarter 2011

- Despite natural disasters in Japan and other countries, increased political turmoil in the Middle East and North Africa, and rising commodities prices, which could hamper the economic recovery in developed countries, equity markets around the world had good performance in the first quarter. The broad US market gained over 6%, with all asset classes delivering positive returns.
- The overall performance in other developed markets was also above average, although it was not nearly as good. As in most of the past few quarters, there was much dispersion in performance at the individual country level. Japan, which suffered the worst earthquake ever recorded there and a subsequent tsunami and nuclear crisis, had sharply negative returns for the quarter. At the other end of the spectrum, some of the worst performers from last year, such as Spain and Italy, were the top performers in the quarter. The US dollar lost ground against most major currencies except the yen, which helped the dollar-denominated returns of developed market equities.
- Emerging markets had subpar but positive returns and trailed developed markets in the quarter. As in developed markets, there was much dispersion in the performance of different emerging markets. Russia and other eastern European countries performed exceptionally well in the quarter. The US dollar also lost ground against the main emerging market currencies in the first quarter, which contributed positively to the dollar-denominated returns of emerging market equities.
- With the exception of small cap value stocks in the US, which underperformed small cap growth stocks, value stocks outperformed growth stocks across all market capitalization segments in the US, in other developed markets, and in emerging markets. Along the market capitalization dimension, small caps greatly outperformed large caps in the US. Outside the US, small caps trailed large caps in other developed markets and greatly underperformed large caps in emerging markets.
- Most fixed income securities had flat or slightly negative returns in the quarter. Inflation-protected securities, which had very strong returns, were the main exception.
- Real estate securities had strong returns in the first quarter and good performance relative to other asset classes.

Three Years as of March 31, 2011

- Equity markets around the world had mixed performance in the three years that ended in March. In US dollar terms, developed non-US markets, which had negative returns, were the worst performers. On the other hand, the US equity market, and especially emerging markets had positive but below-average performance. In the US, the value effect was negative across all market capitalization segments. In developed non-US markets, the value effect was mixed: slightly positive among small cap stocks and slightly negative among large cap stocks. With regard to the size effect, small cap stocks greatly outperformed large cap stocks in the US and in developed non-US markets. In emerging markets, the value effect across all market capitalization segments and the size effect were very strong.
- The US dollar had mixed performance against major currencies. It sharply depreciated against the yen, Swiss franc, and the Canadian and Australian dollars, but appreciated against the British pound and the euro. As a result, currency fluctuations had a small negative impact of around 0.3% per year on the dollar-denominated returns of developed market equities. The US dollar also had mixed performance against the main emerging markets' currencies, and the net impact of currency fluctuations on the dollar-denominated returns of emerging markets strategies was even more muted, approximately 0.1% per year.
- Fixed income delivered annual returns that ranged from 1.6% to 4.7%.
- Notwithstanding the strong returns of first quarter, the three-year returns of real estate securities reflected the continuing weakness in the commercial real estate sector. Real estate securities in the US had small positive returns, while real estate securities in other developed markets had sharply negative returns and were by far the worst-performing asset class.

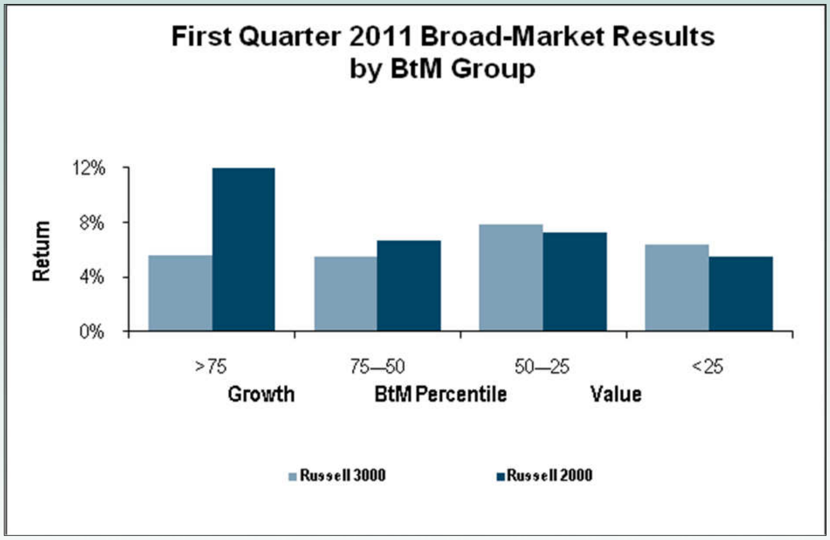
US STOCKS

- Strong returns in January and February gave the US equity market its best first quarter since 1998. Investors were encouraged by improving economic data, especially data related to the labor market, that suggest the economic recovery is becoming more widespread and robust. Despite the earthquake in Japan and the political turmoil in the Middle East and North Africa, the daily volatility of the US market remained moderate. The percentage of trading days with big market movements (defined as days during which the broad US market moved by more than 1% in absolute value) was 21%, compared to about 35% for most quarters last year.
- Another measure of volatility, the Chicago Board Option Exchange's VIX, which measures of the volatility of the S&P 500 Index and has a historical average of around 20, jumped significantly in mid-March when the earthquake struck in Japan, and came back down just as sharply toward the end of the month. Relative to the end of 2010, when it stood at around 18, the VIX was little changed at the end of the quarter. Quarterly returns for the broad US market, as measured by the Russell 3000 Index, were 6.4%. Asset class returns ranged from 6.0% for large cap growth stocks to 9.2% for small cap growth stocks. The strongest sector by far was energy, while the weakest sectors were financials and consumer staples.
- Value had mixed performance relative to growth in the first quarter. Large value slightly outperformed large growth, while small value sharply underperformed small growth. Using the Russell Indexes as proxies, small cap value stocks (Russell 2000 Value) underperformed small cap growth stocks (Russell 2000 Growth) by 2.6% in the first quarter. Large cap value stocks (Russell 1000 Value) outperformed large cap growth stocks (Russell 1000 Growth) by 0.4% in the first quarter. Over the three-year period that ended March 31, the Russell 2000 Value Index underperformed the Russell 2000 Growth Index by 3.4% annualized, while the Russell 1000 Value Index underperformed the Russell 1000 Growth Index by 4.6% annualized.
- Along the market capitalization dimension, small caps (Russell 2000) outperformed large caps (Russell 1000) by 1.7% in the first quarter. Over the three-year period that ended in March, small cap stocks outperformed large cap stocks by 5.6% on an annualized basis.

As of March 31, 2011	**Return (%)**		
Index Returns	**First Quarter**	**One Year**	**Three Years Annualized**
Russell 3000	6.38	17.41	3.42
Russell 2500	8.70	26.12	8.89
Russell 2000	7.94	25.79	8.56
Russell 2000 Value	6.60	20.63	6.76
Russell 2000 Growth	9.24	31.04	10.16
Russell Micro Cap	6.80	25.32	6.46
Russell 1000	6.24	16.69	2.98
Russell 1000 Value	6.46	15.15	0.60
Russell 1000 Growth	6.03	18.26	5.19

US STOCKS

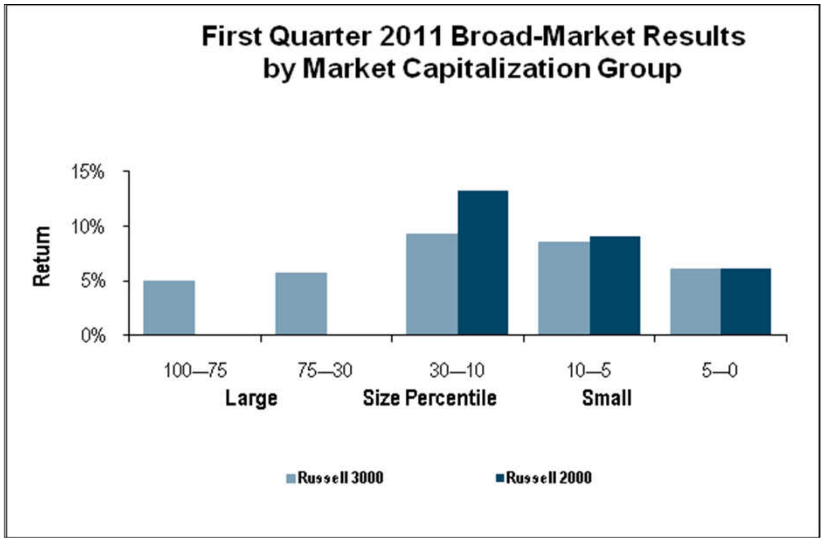
- A look at the determinants of stock performance—relative price and market capitalization—provides some insight into the sources of returns. Historically, value stocks, as measured by the ratio of book-to-market equity (BtM), have outperformed growth stocks, while small stocks have experienced higher returns than large stocks.



- For the Russell 3000 Index, the best performance came from value-oriented stocks in the 25th–50th BtM percentile range, while the worst performance came from growth-oriented stocks in the 50th–75th BtM percentile range.
- For the Russell 2000 Index, the best performance came from deep growth stocks in the 75th–100th BtM percentile range, while the worst performance came from deep value stocks in the 0–25th BtM percentile range.

Russell data copyright © Russell Investment Group 1995–2011.

- For the Russell 3000 Index, the best performance came from mid cap stocks in the 10th–30th market capitalization percentile range, while the worst performance came from mega cap stocks in the 75th–100th market capitalization percentile range.
- For the Russell 2000 Index, the best performance also came from mid cap stocks, while the worst performance came from the smallest stocks in the small cap universe, those in the 0–5th market capitalization percentile range. The dispersion in performance between the best- and worst-performing market capitalization ranges was wide, especially for the Russell 2000 Index.



Russell data copyright © Russell Investment Group 1995 –2011.

NON-US STOCKS

- Developed non-US equity markets as a whole had above-average returns in the quarter, but underperformed relative to the broad US market. The quarterly return for developed markets, as measured by the MSCI World ex USA Index (net dividends), was 3.8%.
- As in most of the past few quarters, there was much variation in performance at the country and asset class levels. For instance, the difference in the quarter between the best-performing developed market, Spain, and the worst-performing one, Japan, was over 18% (13.9% vs. -4.4%).
- In general, European countries with the most severe fiscal problems such as Spain, Italy, and Greece, which were among the worst performers in 2010, experienced a nice rebound and were among the top performers.
- On the other hand, Japan, which had excellent performance until the earthquake struck in mid-March, was by far the worst performer. The weakness of the US dollar against most major currencies except the yen aided developed market equity returns for US investors.
- The US dollar's depreciation ranged from 6.1% against the euro to 1.1% against the Canadian dollar in the quarter. The overall impact of currency fluctuations between the US dollar and developed-country currencies was to increase the dollar-denominated returns of developed market equities by about 2.4%.
- Energy was by far the best-performing sector, while information technology and consumer discretionary were the worst-performing ones.

Non-US Equity Returns

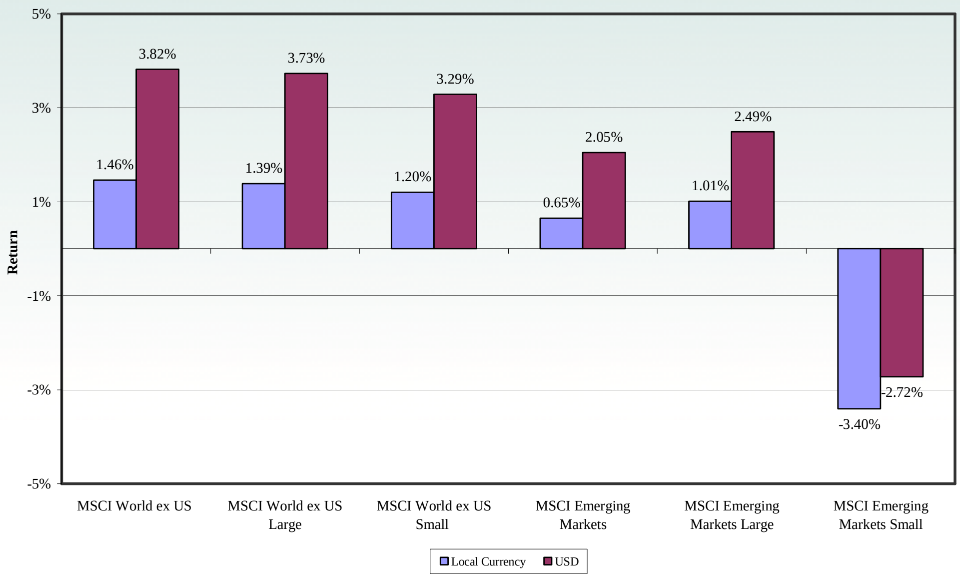
As of March 31, 2011	Return (%)		
Index Returns	**First Quarter**	**One Year**	**Three Years Annualized**
MSCI EAFE Small Cap	2.96	19.94	1.39
MSCI World ex USA Small	3.29	22.00	2.52
MSCI EAFE	3.36	10.42	(3.01)
MSCI World ex USA	3.82	11.60	(2.23)
MSCI EAFE Value	4.55	8.21	(3.57)
MSCI EAFE Growth	2.22	12.55	(2.52)
MSCI Emerging Markets	2.84	18.98	6.19
MSCI Emerging Markets Small	(2.72)	17.74	8.69

MSCI indices are total returns net of foreign withholding taxes on dividends. Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

NON-US STOCKS

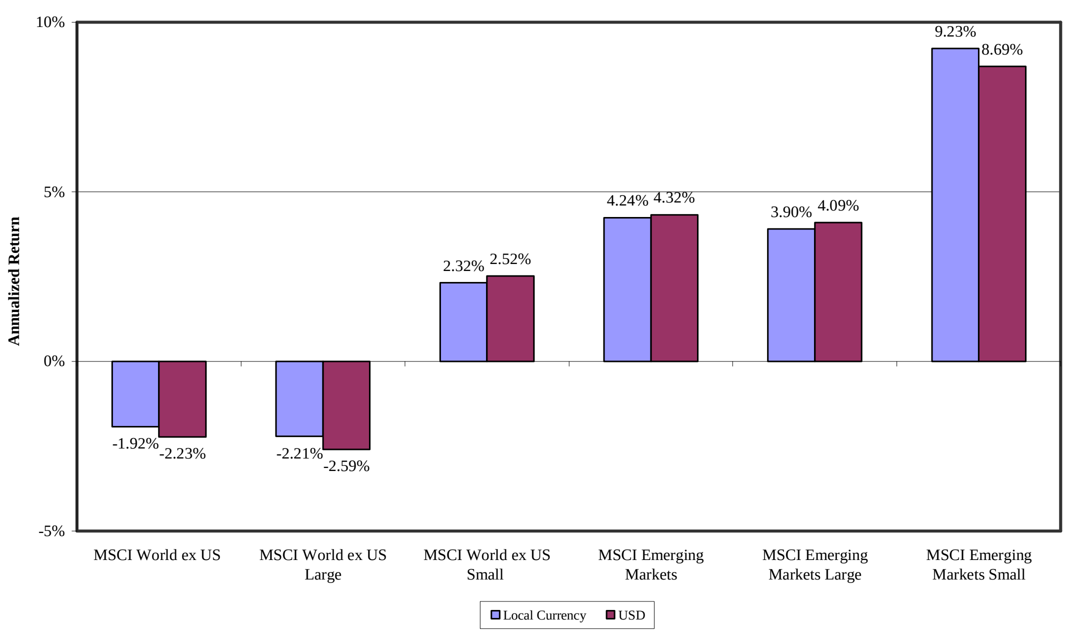
- Using the MSCI World ex USA Index and its sector and country segments as proxies, value stocks in developed markets outperformed growth stocks across both size categories in the quarter. Small cap value stocks (MSCI World ex USA Small Cap Value) outperformed small cap growth stocks (MSCI World ex USA Small Cap Growth) by 1.3%, while large cap value stocks (MSCI World ex USA Large Cap Value) outperformed large cap growth stocks (MSCI World ex USA Large Cap Growth) by 3.4%.
- Over the three-year period through March 31, the value effect was negative in large cap stocks and positive in small cap stocks. Large cap value stocks underperformed large cap growth stocks by 0.8% on an annualized basis, while small cap value stocks outperformed small cap growth stocks by 1.1% annualized.
- Along the market capitalization dimension, in a sharp reversal from 2010, small caps (MSCI World ex USA Small Cap) underperformed large caps (MSCI World ex USA Large Cap) by 0.4% in the quarter. However, over the three-year period that ended in March, small cap stocks outperformed large cap stocks by an annualized 6.0%.

First Quarter Currency Effects on Non-US Equity Returns
As of March 31, 2011



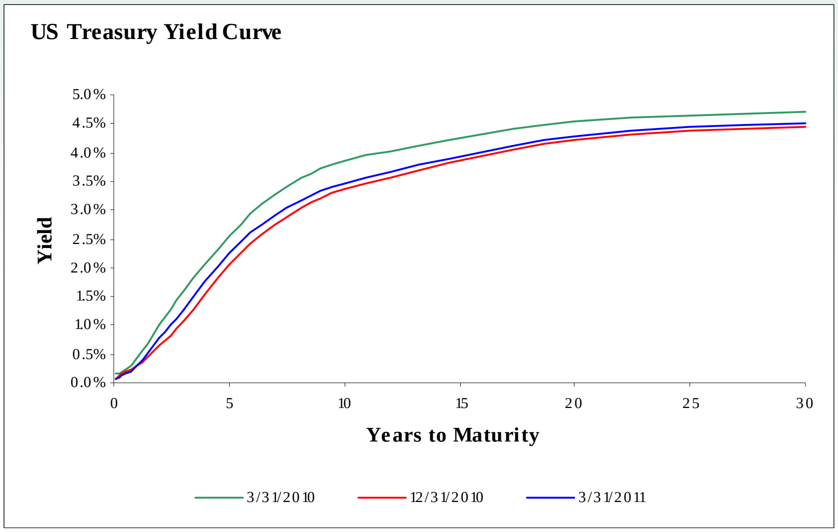
MSCI indices are total returns net of foreign withholding taxes on dividends. MSCI data copyright MSCI 2011, all rights reserved. Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

Three-Year Currency Effects on Non-US Equity Returns
As of March 31, 2011



BONDS

- The Federal Open Market Committee maintained its target range for the federal funds rate between zero and 0.25% in the first quarter, and reaffirmed its goal to maintain that target at very low levels for an extended period.
- In addition, the FOMC decided during its first quarter meetings to continue to purchase $600 billion of long-term Treasury bonds by the end of the second quarter of 2011.
- The goals of this new round of quantitative easing are, according to Federal Reserve officials, to promote the economic recovery and raise inflation to levels that are more in line with the committee's preferred target of around 2%, or even with a higher target of 3–4%.
- Regardless of whether those goals are accomplished, the main effect of this new round of bond purchases will be to shorten the maturity of the US Treasury's outstanding debt, which could make the US government's fiscal position more vulnerable to bad news and could also make the Federal Reserve's exit strategy more difficult to implement successfully.
- As a result of the new quantitative easing program, the Federal Reserve's balance sheet, currently the main focus of monetary policy actions, expanded from about $2.46 trillion at the end of 2010 to about $2.67 trillion at the end of March.
- Yields on very short-term Treasury bills fell slightly or remained flat in the first quarter relative to the end of the fourth quarter, while yields on longer-term Treasury securities rose. As a result, the yield curve steepened. The difference in yield between ten-year Treasury bonds and one-month US Treasury bills was 342 basis points at the end of the first quarter, compared with 333 basis points at the end of 2010. Compared to end of March 2010, however, the yield curve was still lower and the difference in yield between ten-year Treasury bonds and one-month US Treasury bills was smaller at the end of March 2011.



As of March 31, 2011	Return (%)		
Index Returns	First Quarter	One Year	Three Years Annualized
Merrill Lynch Three-Month US T-Bill	0.05	0.16	0.51
Merrill Lynch One-Year US Treasury Note	0.15	0.74	1.45
Citigroup World Government Bond 1-3 Years	(0.08)	0.70	2.35
Barclays Capital US Government Bond	(0.08)	4.28	3.66
Merrill Lynch US Treasury/Agency 1-5 Years	0.04	2.60	3.04
Citigroup World Government Bond 1-5 Years	(0.23)	0.99	2.80
Barclays Capital US TIPS	2.08	7.91	3.93

Global bond idices are hedged. The Merrill Lynch Indices are used with permission; copyright 2011 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Citigroup bond indexes copyright 2011 by Citigroup. Barclays Capital data, formerly Lehman Brothers, provided by Barclays Bank PLC. Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.

REAL ESTATE INVESTMENT TRUSTS (REITs)

- Real estate securities had strong returns in the first quarter and good performance relative to other asset classes. In the US, they performed on par with the broad equity market, outperforming some asset classes and underperforming others.
- In other developed markets, real estate securities outperformed the broad equity market and most other asset classes.

As of March 31, 2011	**Return (%)**		
Index Returns	**First Quarter**	**One Year**	**Three Years Annualized**
Dow Jones US Select REIT	6.70	24.44	1.48
S&P Global ex US REIT	4.46	23.39	(4.03)
S&P Global REIT	5.57	23.79	(0.84)

Dow Jones data (formerly Dow Jones Wilshire) provided by Dow Jones Indexes. S&P/Citigroup data is gross dividends, provided by Standard & Poor's Index Services Group. Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.