2011 Review

*At year-end, we celebrated the three year anniversary of managing capital for our clients. Over this period of time, we have more than doubled the original investment of those clients, substantially outpacing both market benchmarks and peers. In fact, our U.S. Value Equity gross return of 124.2% is **the single highest three year return** of all Large Cap, Mid Cap and All Cap Value products in the eVestment Alliance universe. We are proud of our accomplishments and excited for our future. We thank our clients for their early and continuing confidence.*

In 2011, our U.S. Value Equity composite portfolio generated a gross return of -0.5%, compared to +2.1% for the S&P 500 and +0.4% for the Russell 1000 Value.

	2009	2010	2011	ITD
Lyrical Asset Management (Gross)	+80.2%	+25.0%	-0.5%	+124.2%
Lyrical Asset Management (Net)	+68.4%	+22.3%	-1.2%	+103.5%
S&P 500 (Total Return)	+26.5%	+15.1%	+2.1%	+48.6%
Relative Performance (Net)	+4,190 bp	+720 bp	-330 bp	+5,490 bp

This year, 53% of the stocks in the portfolio outperformed the S&P 500. However, a skew in the distribution of returns drove our overall underperformance. The outperformers in the portfolio exceeded the S&P 500 by an average of 14%, while the underperformers were behind by an average of 20%.

Portfolio turnover in 2011 was 12.5%, which compares to our average turnover of 18.3% per annum over the past three years. We saw plenty of new opportunities within our universe of the top 1,000 U.S. stocks. However, most of those opportunities were comparable to what we already owned, so we did not alter the portfolio.

LOOKING BACK

Like 2010, much of 2011 was ruled by macroeconomic headlines. We witnessed the earthquake, tsunami, floods and nuclear disaster in Japan, the Arab Spring, the continuation of the sovereign debt crisis in Europe, and a credit rating downgrade of the U.S. These significant macro events created fear and uncertainty in the markets which lead to significant price swings over the course of the year. Despite these events and gyrations, our stocks and the market overall finished basically flat for the year.

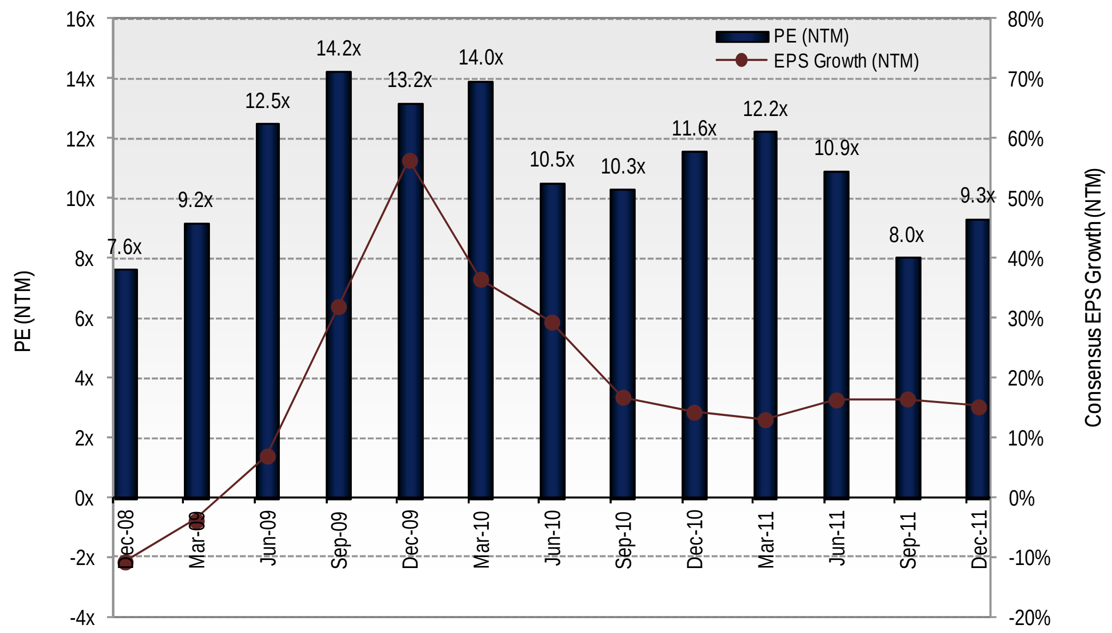
Also like 2010, while there has been so much fear of the macro, there continues to be strength in the micro. According to FactSet, at the start of 2011, consensus for S&P 500 expected 2011 earnings was $91.15. Now, at the end of the year, it appears earnings will be 5.6% higher than expected, at $96.28, representing 13.7% growth over the 2010 earnings of $84.65. For 2012, FactSet's consensus S&P 500 expected earnings is $103.16, an additional 7.1% increase.

LOOKING FORWARD

While the performance of our portfolio was slightly down, the earnings performance of the companies was nicely up. FactSet shows that the companies in our portfolio grew their EPS in 2011 by 10.3%, and the consensus estimates expect 15.4% growth in 2012. Despite this growth expectation, the Forward P/E for our portfolio has declined from 11.5x at the start of 2011 to 9.3x at the start of 2012. The S&P 500 Forward P/E is 12.2x, a 31% premium to our portfolio despite the index's lower expected growth in 2012.

We have very high return expectations for our portfolio, especially given its attractive combination of solid fundamentals and low valuation. The following chart shows the current portfolio Forward P/E of 9.3x is the lowest we have seen since March 2009. Back then the consensus expected growth rate of the portfolio was -3.8% compared to 15.4% today.

Historical Portfolio Metrics



Source: FactSet; Lyrical analytics

2009 + 2010 + 2011 = #1

We are true long term investors with the goal of maximizing long term returns. Since our inception, we have been successful at meeting that goal. We used eVestment's performance database and examined the returns of all Large Cap, Mid Cap and All Cap Value products. While not all of these products are true peers of ours, we wanted to cast a wide net in capturing the performance data. In total, as of January 19, 2012 there are 590 products in those three categories that reported returns for 2009, 2010 and 2011. Lyrical Asset Management's U.S. Value Equity gross return of 124.2% was the highest three year return in that universe, and exceeded the second highest return by 524bp.

While not every three year period will be as successful as this past one, we believe our strategy, process and execution can continue to sustainably and consistently deliver excellent long term returns.

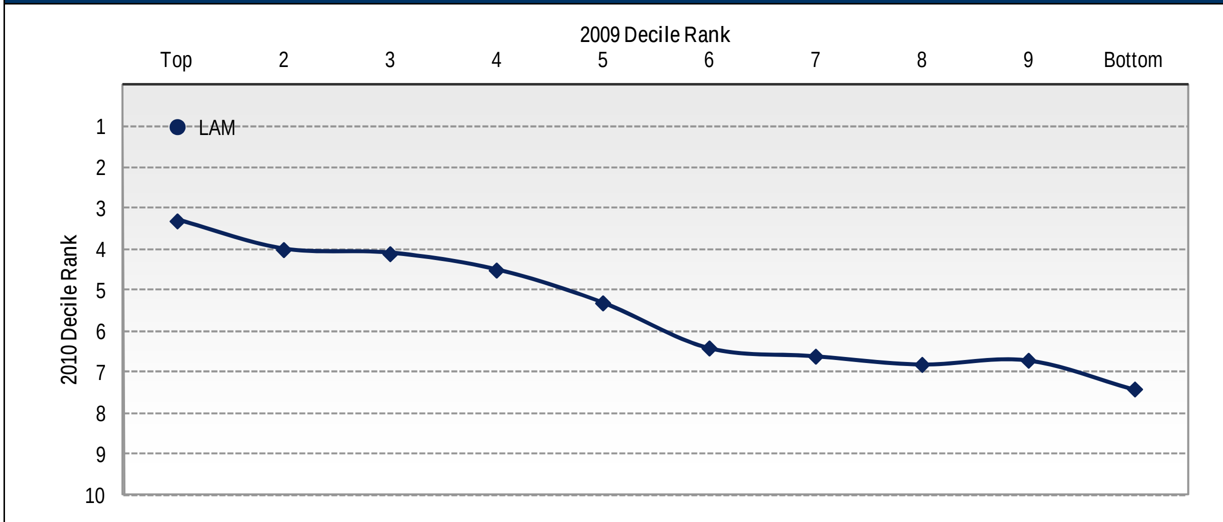
2011 WAS TOUGHER THAN IT LOOKED

While we are certainly proud of our success over the past three years, we are nonetheless disappointed not to produce a positive return and outperform the benchmarks in 2011. What may not be apparent in our performance this year is just how bad a year it was for many of our peers. The factors that drove success in 2009 and 2010 seemed to reverse in 2011.

Using the eVestment performance database, we tracked the 590 products mentioned above for how their performance rankings migrated over the past three years. Specifically, we grouped products into deciles based on 2009 performance, and then plotted the average decile of where they ranked the following year in 2010. For example, the 59 products that placed in the top decile in 2009 had an average decile ranking of 3.3 in 2010, and the 59 products in the second decile in 2009 had an average decile ranking of 4.0 in 2010.

As the line plot shows, the best products in 2009 also averaged out to be the best products in 2010. The trend was fairly consistent from the top to the bottom, and the statistical correlation of 2009 versus 2010 returns was very strong at +47%.

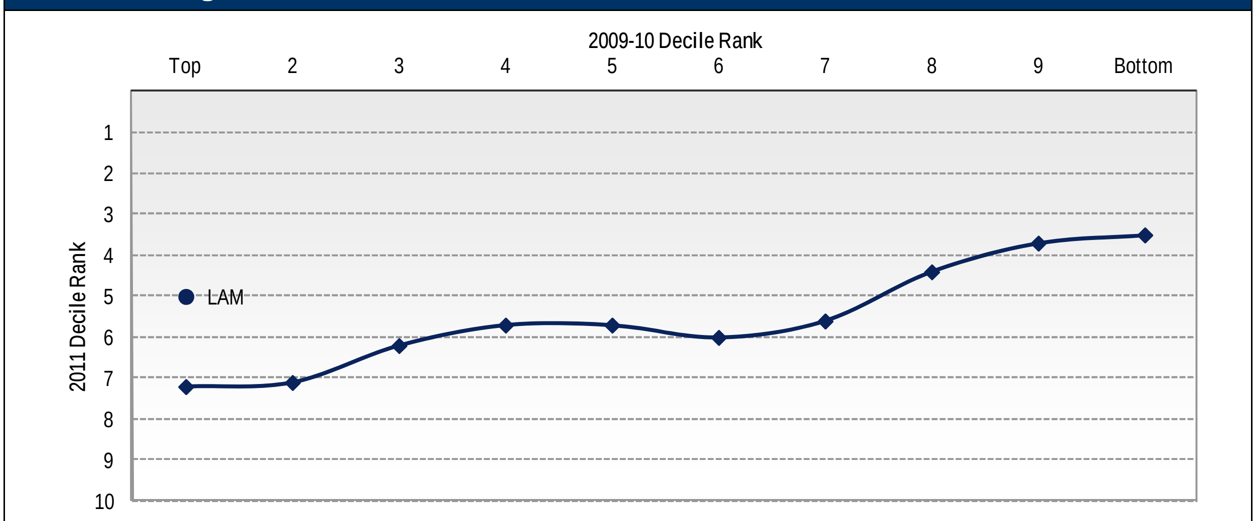
Decile Rank Migration: 2009 to 2010



Source: eVestment Alliance; Lyrical analytics

However, when we compare the decile rank of the two year return of 2009–10 to the returns of 2011, we see the opposite result. Those that performed best in 2009-10 performed worst in 2011, and again, the trend was fairly consistent from top to bottom. The statistical correlation was also very strong, but negative, at -38%.

Decile Rank Migration: 2009-10 to 2011



Source: eVestment Alliance; Lyrical analytics

Among our peers with excellent two year results in 2009-10, we had one of the best results in 2011. Our two year gross return for 2009-10 was 125.3%, fourth best of the 590 in the database. There were fifteen other products that produced two year returns over +100% for the 2009-10 period. Those fifteen products averaged a return of -7.9%, far worse than our -0.5%.

The point of all this is to demonstrate that 2011 was an adverse environment for our approach to investing, as this objective peer group analysis supports. The stock market was focused on short term macro, while our investment focus is always on long term fundamentals.

Adverse environments can reveal a lot about a manager, and we believe 2011 affirms the robustness of our approach. In a year like 2011, when most of the fifteen managers who were up +100% or more in 2009-10 dropped to the 9th and 10th deciles, our gross result was still above the -0.6% average return of all Large Cap, Mid Cap, and All Cap Value products in the eVestment database.

TAKING THE POTHOLES OUT OF DEEP VALUE

In our 2009 letter we provided evidence supporting our view that a deep value strategy is a highly effective approach to long term investing. We showed how investing in the cheapest price-to-book stocks produced market beating returns and lower incidence of loss over the past 50+ years. However, years like 2008 and 2011 expose some of the shortcomings of the deep value approach for some investors.

As much as we would like, we can't have our cake and eat it too. If we want the benefits of the higher long term returns, we unfortunately have to put up with some unpleasant times. Observe that in the past 36 months, while we have produced a gross return of 124.2%, we have also experienced several bumps along the way, including months with double digit losses of -14.2%, -10.9%, -10.2%, -10.1%. We would prefer not to have these monthly losses and instead see steady upward progress month after month, but that is not how our world works.

While we cannot eliminate all the bumps, we believe our approach has the potential to smooth over some of the worst of them. One way we do this is by prudently limiting our concentration risk in the portfolio. The portfolio is mostly equally weighted across our 30-40 positions, and no stock has ever exceeded 3% of assets, at cost. We also have industry limits, such that no industry can be more than 10% of assets, at cost.

We also seek to eliminate bumps by only investing in quality businesses and avoiding balance sheets with excessive debt. Furthermore, we only invest in businesses we feel we can properly analyze and understand. For example, we have not been invested in banks because the opacity of their risk exposures and uncertainty in the global credit markets makes it too difficult for us to analyze these businesses. And, if we can't properly analyze them, we have no business owning them.

Importantly, we believe these smoothing steps do not diminish the return potential of the product when times are good for value investing. We believe that the stocks in our portfolio are as discounted as any portfolio produced by our deep value peers, and when value factors are working in the market, we have the potential to produce returns as good as the best of them.

WE ARE UNIQUE (AND WE CAN PROVE IT)!

There are other firms that share some common traits with our approach, but there are always some differences, and these can result in markedly different portfolios. To prove the uniqueness of our total investment approach, we commissioned FactSet to help us with an analysis. The SEC requires all investment managers with over $100mm in assets under management to submit quarterly a Form 13F reporting their equity holdings. We examined the universe of 2,000+ 13F filings and compared our holdings to those in every 13F to see which firms had a similar portfolio to ours. Even we were a bit surprised by the results. Our single best match out of 2,247 filings had only a 13.5% overlap with our portfolio. In total there were eleven filers with an overlap 10%+. So against our very best matches, our portfolio is almost 90% different.

A benefit of this low overlap is that clients can invest in our U.S. Value Equity product and know they are likely getting exposure to stocks that they are not getting from their current managers.

CONCLUSION

We have been managing capital for our clients for three years, and we have demonstrated that we are capable of producing results that lead our peers. In good years for value investing, we have shown we can be among the best, and in an off year like 2011, we have shown we can avoid some of the pitfalls. This success has not come from rapid repositioning, as only 12.5% of the portfolio turned over in 2011, and cumulatively only 55% has turned over in the last three years. Rather it comes from a robust investment approach that we believe has been engineered for success. We believe we offer an investment proposition not only that has been successful for the past three years, but also one that should endure for the next thirty years and beyond.

Andrew Wellington,
Managing Partner
Chief Investment Officer

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THE S&P 500 INDEX IS A MARKET CAPITALIZATION WEIGHTED INDEX COMPRISED OF 500 WIDELY-HELD COMMON STOCKS.

THE RUSSELL 1000 VALUE INDEX MEASURES THE PERFORMANCE OF THE LARGE-CAP VALUE SEGMENT OF THE U.S. EQUITY UNIVERSE. IT INCLUDES THOSE RUSSELL 1000 COMPANIES WITH LOWER PRICE-TO-BOOK RATIOS AND LOWER EXPECTED GROWTH VALUES. THE RUSSELL 1000 VALUE INDEX IS CONSTRUCTED TO PROVIDE A COMPREHENSIVE AND UNBIASED BAROMETER FOR THE LARGE-CAP VALUE SEGMENT. THE INDEX IS COMPLETELY RECONSTITUTED ANNUALLY TO ENSURE NEW AND GROWING EQUITIES ARE INCLUDED AND THAT THE REPRESENTED COMPANIES CONTINUE TO REFLECT VALUE CHARACTERISTICS.