



NorthPointe Capital  
2<sup>nd</sup> Quarter 2011 SCV Commentary

## **General Market Commentary for the Second Quarter of 2011**

The first half of 2011 is now in the history books. The record shows moderately positive returns for domestic equities. Focusing solely on a single data point would fail to accurately describe the wild ride that has thus far been 2011. From optimism to natural disaster to regime change to federal budgets & balance sheets to Greece austerity, 2011 has experienced a healthy dose of market defining events. During the second quarter, small caps underperformed as the Russell 2000<sup>®</sup> Index declined 1.61% as compared to the 0.12% increase for the large company Russell 1000<sup>®</sup> Index. Value stocks, which had greater exposure to the underperforming Financials sector as well as less exposure to the outperforming Health Care sector, underperformed growth stocks as the Russell 2000<sup>®</sup> Value Index declined 2.65% relative to the 0.59% decline in the Russell 2000<sup>®</sup> Growth Index for the second quarter.

We remain cautiously optimistic for the second half of the year. On the negative side of the ledger, disappointing economic news has given us pause. High unemployment and continued pressure on housing remain substantial issues. However, our optimism stems from the attractive valuations and robust fundamentals of your portfolio holdings. The story we see unfolding from a bottom up perspective is quite different from the macro led headlines. Record high yield bond issuance, increased M&A activity, the Presidential cycle, and a potential inflection point in loan demand support a constructive second half. A continuing trend of declining stock level correlation has set the stage for the successful stock picker. It is our belief that our stock picking skills will be on visible display in the second half.

## **Portfolio Commentary**

For the quarter ending June 30, 2011, the portfolio outperformed the Russell 2000<sup>®</sup> Index. The largest contributors to performance were strong stock selection in the Health Care, Information Technology and Materials sectors. Within Health Care, the stock of Team Health Holdings, Inc. reacted well to a favorable earnings report. Team Health, a provider of outsourcing services to hospital emergency rooms, continues to benefit from the trend toward outsourcing and an increase in patient admissions. Additionally, Akorn, Inc., a manufacturer of generic drugs, continued to execute a successful turnaround strategy and the Company's stock reacted accordingly. Portfolio performance was positively impacted by merger activity as EMS Technologies, a provider of communication systems, was acquired at an attractive premium to the current stock price. Within Materials, the stock of agricultural chemicals provider American Vanguard advanced nearly 50% during the quarter as demand for the Company's insecticide products remained strong.

The largest detractors to performance were individual stock declines within the Energy and Materials sectors. Global Industries, Ltd., a provider of off-shore construction services to the oil and gas industry, experienced delays in project activity due primarily to permitting issues in the Gulf of Mexico. Investors sold off the stock in response to the difficult near term operating environment. As we still believe in the long term success of the Company, we continue to maintain our investment in Global and have increased the position opportunistically. The stock of Coeur d'Alene Mines Corp., an explorer and operator of silver mines, suffered as investors became concerned about the rumored nationalization of its Bolivian operations as well as a significant decline in the price of silver. Due to the uncertainty and magnitude of potential changes surrounding the Company, we sold our position.

At the end of the second quarter, the portfolio's largest investments were in EnPro Industries, Inc., Akorn, Inc., and Dollar Financial Corp. EnPro, a manufacturer of engineered industrial products benefited from strong end markets and several acquisitions which enabled the Company to sell complimentary products within its core business units. The stock of EnPro was one of the portfolio's best performers during the quarter, delivering strong returns on an absolute and relative basis. As previously discussed, the stock of Akorn also had favorable returns. Dollar Financial, a provider of consumer financial services reported earnings that exceeded consensus estimates and continued to make attractive acquisitions. The stock was an outperformer on an absolute and relative basis.

### ***Research Efforts***

We continue to focus our research efforts on identifying companies that have specific near term catalysts whose stocks are currently being undervalued by the market. No matter the macroeconomic environment or current investor sentiment, the universe of small cap stocks is broad such that we are confident our due diligence process will continue to discover attractive investment opportunities.

For current holdings, we remain vigilant in monitoring valuation levels relative to the catalysts that have occurred, or are expected to occur, to ensure that the portfolio contains only the most attractive investments. We have paid particular attention to the portfolio's stocks that have outperformed in both rising and falling markets and have been opportunistically increasing the investment in such names when the situation merits.

### ***Sector or Industry Shifts***

As the quarter began, the largest overweight exposure relative to the Russell 2000<sup>®</sup> Index was to the Financials sector. Due to the initiation of several investments of companies in the chemical industry, Materials became the largest overweight sector at the end of the quarter. However, the portfolio remained overweight to the Financials sector.

Throughout the quarter, the portfolio was notably underweight the Utilities, Information Technology and Health Care sectors. However, due to the strong performance of an investment in a generic drug manufacturer, the Health Care sector was replaced by the Utility sector as the largest underweight exposure by the end of the second quarter.

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*The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.*