



## NorthPointe Capital 4Q11 Small Cap Value Commentary

### General Market Commentary for the Fourth Quarter of 2011

Equity markets surged in the fourth quarter of 2011. Major equity indices posted double digit returns, as concerns over the European debt crisis dissipated and underlying strength in the U.S. economy provided confidence. Small capitalization stocks outperformed large caps during the fourth quarter as the Russell 2000<sup>®</sup> Index returned 15.47% as compared to the 11.84% return of the large company Russell 1000<sup>®</sup> Index. For the year; however, large caps outperformed small caps as the Russell 1000<sup>®</sup> Index returned 1.5% as compared to the 4.18% loss in the Russell 2000<sup>®</sup> Index. Value stocks, which had substantially larger exposure to the outperforming Financials sector, outperformed growth stocks in the fourth quarter of 2011 as the 15.97% gain in the Russell 2000<sup>®</sup> Value Index bested the 14.99% gain in the Russell 2000<sup>®</sup> Growth Index. Yet for the full year, value stocks underperformed as the Russell 2000<sup>®</sup> Value Index experienced a 5.5% loss while the Russell 2000<sup>®</sup> Growth Index lost 2.91%. This disparity between value and growth on a full year basis was due to underperformance within the Industrials and Financials sectors of the Russell 2000<sup>®</sup> Value Index.

Uncertainty seems to be the pundit's word of choice when describing the investment outlook for 2012. We agree. This is precisely why we have positioned your portfolio to be successfully driven by our stock selection. Home to our confidence is our ability to pick stocks and our stock selection has been and will continue to be our instrument for delivering value.

### Portfolio Commentary

For the quarter ending December 31, 2011, the portfolio outperformed the benchmark, the Russell 2000<sup>®</sup> Index. The outperformance was highlighted by strong contribution from the Health Care, Energy and Consumer Discretionary sectors. The stock of Akorn, Inc., a manufacturer of generic pharmaceuticals, continued its strong advance as management made several strategic deals that should provide very attractive growth opportunities for the Company. Additionally within Health Care, the portfolio benefited from the performance of Examworks Group, Inc., a provider of independent medical exams. We have monitored Examworks since it came public in late 2010 and identified an attractive buying opportunity when investors sold off the stock due to (what we perceive to be) temporary operating concerns. As these issues appear to have subsided, the stock has moved higher. As the stock market declined sharply in early October, we reinitiated a position in Kodiak Oil & Gas Corp., a Company we monitor closely despite exiting the stock earlier in the year at higher levels. The purchase was timely as the stock more than doubled and became the best performing stock in the portfolio for the quarter. Kodiak delivered strong production results and made several acquisitions to increase its

acreage in the Bakken shale that were well received by investors. Outperformance in the Consumer Discretionary sector was led by Charming Shoppes, Inc., a retailer of women's apparel. The stock experienced a strong advance late in the quarter as management announced it would undertake a "strategic review" which could include selling the underperforming Fashion Bug store chain and focusing efforts on expanding the strong Lane Bryant brand.

Detracting from performance were the negative stock selection scores within the Information Technology and Financials sectors. The stock of Pegasystems, Inc., a provider of customer relationship management software, declined as the Company missed consensus earnings estimates due to delays in closing sales deals and management commentary on soft pricing. As we had little visibility to the resolution of these issues, we sold the investment in Pegasystems. Two of the portfolio's semiconductor holdings, RF Microdevices, Inc. and Silicon Image, Inc., suffered declining stock prices when earnings estimates were reduced due to soft end markets. We maintain our position in these stocks as we see early signs of a recovery and believe the stocks trade at attractive valuations. After turning in a strong performance for the first three quarters of 2011, the stock of DFC Global, a provider of consumer loans and pawn services, declined throughout the fourth quarter. Investors became concerned that the U.S. government would enact financial regulation that would have a detrimental impact on the Company. We continue to view DFC Global very favorably as over 85% of its business is generated outside of the United States.

At the end of the fourth quarter, the portfolio's largest investments were in BBCN Bancorp, Inc., Ocwen Financial Corp. and Kodiak Oil & Gas Corp. The stock of BBCN Bancorp, a provider of banking services to individuals and small-to-medium sized businesses, was the best performing stock within the Financials sector gaining in excess of 50% during the quarter as the Company acquired a similar sized banking company and reported improving credit metrics. The stock of Ocwen Financial, a loan servicing company, rose during the quarter but underperformed relative to the outperforming Financials sector. As discussed above, the investment in Kodiak more than doubled during the fourth quarter of 2011.

## **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.

## Sector or Industry Shifts

At the beginning and end of the quarter, the largest overweight exposure relative to the Russell 2000<sup>®</sup> Index was to the Financials sector. The Materials and Consumer Discretionary sectors had large relative overweight positions as the quarter began; however, the sale of a metal company and several retailers reduced the extent of these overweight positions. Throughout the quarter, the portfolio maintained a relative underweight position to the Consumer Staples and Information Technology sectors. Within Health Care, the addition of several attractive investments caused the portfolio to move from a relative underweight position at the beginning of the quarter to a relative overweight position at quarter's end. There were no other significant sector shifts.

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*The Russell 2000<sup>®</sup> Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000<sup>®</sup> companies with higher price-to-value ratios and higher forecasted growth values.*

*The Russell 2000<sup>®</sup> Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000<sup>®</sup> Index is a subset of the Russell 3000<sup>®</sup> 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.*

*The Russell 2000<sup>®</sup> Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000<sup>®</sup> companies with lower price-to-book ratios and lower forecasted growth values.*

*The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000<sup>®</sup> Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership*