

Sparta U. S. Small Cap Growth

4th Qtr 2007 Commentary

THE MARKET

The year 2007 proved to be one of the most challenging environments in recent memory for most fundamental growth investors. It was a tale of two markets. During the first half of the year, strong corporate earnings, an abundance of liquidity and a weak U.S dollar spawned a great number of acquisitions by strategic long-term oriented companies. On one hand, large corporations found unique and innovative companies taking small amounts of their market share as they were struggling to grow their own businesses beyond the overall rate of GDP growth. On the other hand, small companies have seen the cost of Sarbanes-Oxley compliance soar and the emergence of short-sighted activist shareholders pushing them to unlock "shareholder value" at the long-term expense of their business and employees. We were the beneficiaries of a multitude of these cash buyouts and tender offers during this unique period. In the first half of 2007, nine of the names held in our portfolio were bought-out by larger companies. One such example was Pitney Bowes' acquisition of MapInfo (MAPS). MapInfo, a leader in geographic and demographic management software (used by national retailers to plan new store locations, more effectively target advertising, etc.) was a \$13 stock with nearly \$5 in cash, no debt and growing revenues. Pitney Bowes' dominant postal metering business was mature and they were looking for ways to expand their direct marketing business. By combining MapInfo's capabilities with their existing direct marketing tools and services they are now able to "geo-target" their direct marketing messages. For example, when a credit card holder receives a statement, it might include messages or relevant coupons related to buying patterns during that month to encourage "like" purchases in the future. They paid \$20.25 cash for MAPS, a 55% premium. It's during these rational market periods when quality and fundamentals matter, that our specific philosophy flourishes. Unfortunately, then came July...

Fear and uncertainty; these are the words that best describe the psychology of the investor and the markets over the last half of 2007 and into early this year. A confluence of events, culminating with the sub-prime mortgage collapse in July, triggered a stampede of investors rushing to the few areas of the market they felt safe. This is known as the "herding effect". During short-term periods of fear and uncertainty, investors will ignore all fundamentals and reason in exchange for safety in numbers. This perceived "safety" is typically viewed in large, liquid companies. The idea being, "if it's big enough and everyone else owns it, then I can easily sell it if it's a mistake". Clear evidence of this can be seen in the Russell 2000 Growth Index at the end of 2007. Of the approximately 1600 companies in the index, the Top 10 largest by market cap (all over \$3 billion, with one actually over \$8 billion due to a merger) accounted for the ENTIRE 7% return for the year. Today, this phenomenon is compounded with the proliferation of ETFs (Exchange Traded Funds) and Index Funds over the last several years. No one was

picking stocks in the last half of 2007, but rather pouring all of their assets into the broad market via these ETFs and Indexes in search of “safety”. Evidence of this effect can be seen in the average daily trading volume of the ETFs that track the Russell 2000 Growth index. Over the course of 2007, the average daily volume increased by a staggering 159%! So, you can see, the biggest companies in these indexes and ETFs got all the attention, and thus, all of the price appreciation.

THE PORTFOLIO

The market conditions and environment the last half of 2007 represented a major contradiction to our core philosophy as a fundamental institutional money manager. For 12 years, we have built a track record based on a vigilant discipline of knowing the companies we own and paying only rational prices for their growth. This philosophy is further driven by the objectives of our clients. We are singularly focused on the long-term growth of assets for our institutional clients. We are not influenced or wavered by short-term market conditions that could tempt us to deviate from this discipline.

We actively manage a portfolio of approximately 50-55 small cap companies. Our view is that we own pieces of companies, not stock certificates. We only own companies with a market cap of \$100mm to \$3B at purchase irrespective of the sizes of companies in the benchmark index. We have, and always will, deem this to be truly “Small Cap”. We screen for companies with little or no debt and abundant free cash flow. This enables small companies to weather difficult market environments, while sustaining real growth. We employ a simple, yet critical financial formula called Enterprise Value. This calculation (Market Cap – Cash +Debt) reveals the true cost we are paying for ownership in a company. Finally, we identify growth catalysts that will begin to materialize over the next 8-12 months for these companies. Catalysts like a change in management, new product introductions, new patents or royalties, etc. This fundamental process of selecting stocks based on first-hand research and knowledge has proven results over full market cycles.

PERFORMANCE

Our performance in 2007 was again, a tale of two markets reflecting the starkly different market environments in each half of the year. Through June 30, 2007 the one-year performance for the Sparta U.S. Small Cap Growth composite was 33.51% gross of fees (32.41% net of fees) vs. 16.83% for the Russell 2000 Growth Index¹. This gave us the number 1 ranking among all domestic small cap growth managers for the trailing one-year period (according to the Evestment Alliance manager universe).

For the year ending 2007, our composite’s gross performance was 3.00% (1.98% net of fees) vs. 7.05% for the R2000G Index¹. This is the first year since 1998 that we have trailed the index and only the second time since the inception of this strategy 12 years ago. We are in no way satisfied with these results, nor do we expect you, our client, to be either. However, we are confident in our knowledge of why we underperformed during this period and are unflinching in our approach to managing this

portfolio. It's important to note that our interests as a firm are in direct alignment with those of our clients. As a boutique investment firm, managing only this one strategy, we share the pain of market losses and underperformance with you. We pledge our continued commitment to you that all of our resources and focus are aimed at improving on these results.

OUR VIEW

We firmly believe quality and fundamentals drive stock prices over the long-term. The last few quarters have shown that we are not immune to the short-term emotional gyrations of the markets. However, it's our opinion that the markets have overly discounted the valuations of many of our holdings without any regard for the underlying fundamentals of their businesses. We view "risk" as the rate at which any investment rises without the corresponding fundamentals rising at the same rate. Stocks that have gone up in price without a corresponding rise in their underlying fundamentals become more risky. This is what we consider "speculative". Conversely, stocks which have gone down in the short term even as their fundamentals have improved are less risky. These stock price disconnects create opportunities for the patient growth investor and are where we've been positioning the portfolio over the last few quarters.

We have strategically positioned our portfolio during this volatile period, primarily focused on upgrading our longer-term risk/reward profile while the market is giving us opportunities to own wonderfully run growth companies at incredible prices. These companies continue to be focused in Information Technology, Semiconductors, Healthcare, Industrials, and Energy. We have held an underweight position in Consumer Discretionary companies over the past quarter, but have become more intrigued at current valuation levels. We are beginning to add to companies in this sector that are in a good position to grow their footprint across the country and internationally over the next few years. These particular companies are less dependent on the overall retail environment since they are continually adding 10-20% more square footage growth on a yearly basis in areas of the country they never served in the past. This gives them a growth buffer during downturns and allows for great earnings acceleration when the economy picks back up.

The current period is just one bump in the road which has also presented some of the most compelling risk/reward opportunities in some select stocks in the portfolio that I have not seen since late 2002. At year end, the current companies in our portfolio had earnings growth in 2007 of roughly +31% while our portfolio was only up +3%. Heading into 2008, the expected growth of all these same companies is +38.6% while factoring in a potential recession. At the same time, the current P/E ratio that we are paying for that future growth is only 15.2x those forward earnings.

We assure you that our focus is singular and our efforts vigilant. Thank you for your continued confidence and support!

Sincerely,

Ryan Carr

CIO, Managing Partner

¹ Index returns from Russell Investments

The volatility of indices may be materially different from the individual performance attained by a specific investor. In addition, Adviser's holdings may differ significantly from the securities that comprise the indices. The indices have not been selected to represent an appropriate benchmark to compare an investor's performance, but rather are disclosed to allow for comparison of the investor's performance to that of certain well-known and widely recognized indices. You cannot invest directly in an index.

Past performance is not indicative of future results. The Sparta Asset Management, LLC U.S. Small Cap Growth Equity composite consists of fully discretionary equity portfolios seeking to achieve long-term capital appreciation by identifying securities of small-capitalization growth companies with the potential for significant long-term price appreciation. Performance shown for the Sparta U.S. Small Cap Growth Equity composite includes the reinvestment of all income.

COMPOSITE PERFORMANCE

COMPOSITE ASSETS

ANNUAL PERFORMANCE RESULTS

YEAR	TOTAL FIRM ASSETS END (THOUSANDS)	USD (THOUSANDS)	NUMBER OF ACCOUNTS	COMPOSITE GROSS	COMPOSITE NET	RUSSELL 2000 GROWTH	COMPOSITE DISPERSION
2007	167,000	90,195	five or fewer	3.00%	1.98%	7.05%	n.a.
2006	n.a.*	74,211	five or fewer	14.96%	13.98%	13.35%	n.a.
2005	n.a.*	1,251	five or fewer	10.73%	9.63%	4.15%	n.a.
2004	n.a.*	11,160	43	18.41%	16.81%	14.31%	0.43%
2003	n.a.*	6,159	24	55.71%	53.44%	48.54%	0.96%
2002	n.a.*	2,639	12	(12.51%)	(14.04%)	(30.26%)	0.66%
2001	n.a.*	3,388	15	(5.68%)	(7.33%)	(9.23%)	0.96%
2000	n.a.*	4,011	20	11.21%	9.40%	(22.43%)	3.94%
1999	n.a.*	2,807	12	74.75%	72.18%	43.09%	n.a.
1998	n.a.*	941	five or fewer	(3.75%)	(5.40%)	1.23%	n.a.
1997	n.a.*	742	five or fewer	22.89%	20.76%	12.95%	n.a.
1996	n.a.*	245	five or fewer	31.38%	29.09%	11.26%	n.a.
1995	n.a.*	108	five or fewer	—	—	—	—

US SMALL CAP GROWTH EQUITY DISCLOSURE

Sparta Asset Management, LLC (SAM) US Small Cap Growth Equity Composite consists of fully discretionary equity portfolios seeking to achieve long-term capital appreciation by identifying securities of small-capitalization growth companies with the potential for significant long-term price appreciation. The composite is measured against the Russell 2000 Growth Index. The minimum account size for inclusion in the composite is currently \$250,000. From July 1, 2005 through September 14, 2007 the minimum account size was \$1,000,000. Prior to July 1, 2005 the minimum account size was \$100,000.

Sparta Asset Management, LLC has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

Sparta Asset Management, LLC is a registered investment advisor. The firm maintains a complete list and description of composites, which is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results.

The US Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Net of fee performance was calculated using highest management fee of 1.00%. Prior to July 1, 2007 net of fee performance was calculated using actual management fees. Prior to July 1, 2005, the composite was comprised of 100% bundled fee accounts and the gross performance was reduced by transaction costs. The annual composite dispersion presented is an equal-weighted standard deviation calculated for the accounts in the composite the entire year. Additional information regarding the policies for calculating and reporting returns is available upon request.

The management fee schedule is as follows: 1.00% on first \$25 million; 0.85% on next \$25 million; 0.80% on next \$50 million; and 0.75% on assets over \$100 million. Each client's returns will be reduced by the advisory fee and any other expenses incurred in the management of the investment advisory account. Actual investment advisory fees incurred by clients may vary.

The SAM US Small Cap Growth Equity Composite was created on September 17, 2007. All performance shown prior to September 17, 2007 is that of the Small Cap Growth Equity portfolio composite managed at a prior firm. The Portfolio Manager was the only individual responsible for selecting the securities to buy and sell. Performance shown from the prior firm does not necessarily indicate how the SAM US Small Cap Growth Equity Composite will perform in the future.

This performance information gives some indication of the risks of an investment in the SAM US Small Cap Growth Equity Composite. Performance figures for the period ended shown herein represent a composite of fully discretionary, fee-paying SAM equity accounts above \$250,000. The composite is size weighted and includes terminated accounts. The returns presented reflect the reinvestment of dividends and other earnings. Beginning September 17, 2007, composite policy requires the temporary removal of any portfolio incurring a client-initiated significant cash inflow or outflow of 10% or more of portfolio assets. This will cause the account to be removed for the month in which the large inflow or outflow occurred. The account will be re-included in the composite the month following the large inflow or outflow. Sparta Asset Management, LLC will document the date of the cash inflow or outflow, date the account is removed, and date the account is re-included. Sparta Asset Management, LLC will also document the amount of the inflow and outflow and identify if it is a contribution or withdrawal from the portfolio. Additional information regarding the treatment of significant cash flows is available upon request. US dollars are the currency used to express performance. There is no guarantee that the portfolio manager will achieve similar results in the future. Please refer to the Sparta Asset Management, LLC Form ADV Part II for a full disclosure of the fee schedule and other detailed information regarding the services offered. The returns presented have sustained significant gains and losses due to market volatility.

Index Information

The Russell 2000 Index is a market value weighted index of the 2000 smallest US companies in the Russell 3000 Index, which includes 3000 of the biggest US stocks. The Russell 2000 Growth Index consists of those Russell 2000 companies with higher price-to-book and higher forecasted growth values. An index is unmanaged and is not available for direct investment.