

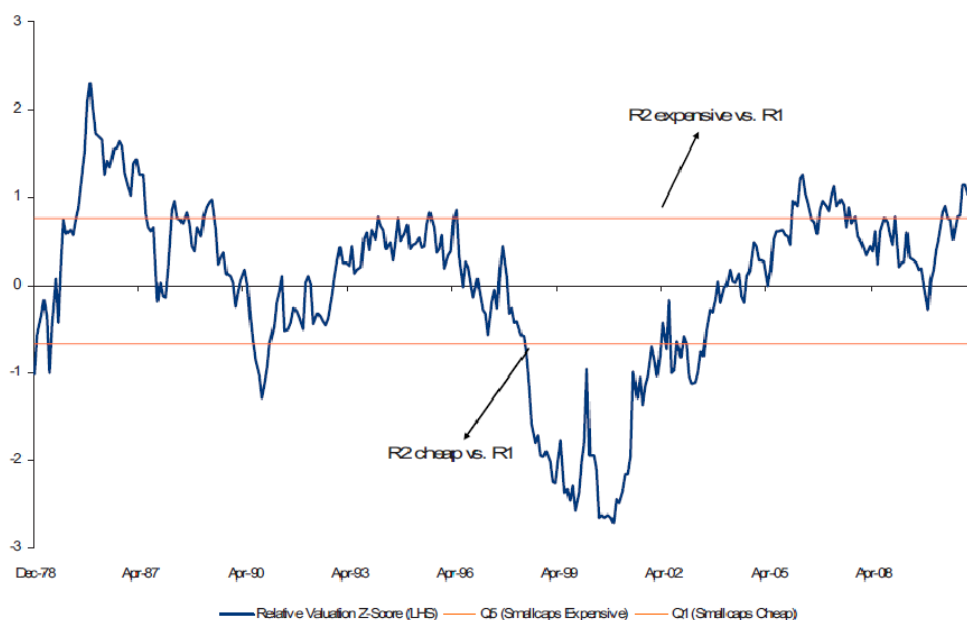
Convergence Core Plus

May 2011 Commentary

The Meaning of “Plus” in a Changing Market.

Since August of 2010, the stock market has been on a near uninterrupted advance. Large cap stocks as represented by the Russell 1000 are up 32.85% and small cap stocks are up 44.76% as represented by the Russell 2000 Index. In the past few days, however, new anxiety has returned. Economic growth shows signs of slowing, labor market statistics have reversed their previously tepid advance, and the stock market appears to have at least temporarily “rolled over.”

Within the market an important dynamic is also taking place. Small capitalization stocks, which have been on a rapid advance since the market turned on March 9th, 2009, have now become expensive relative to their larger brethren. The chart below uses Merrill Lynch’s valuation model to compare the relative valuation of small cap stocks versus large cap stocks. Small cap stocks are more expensive relative to large cap stocks than any other time since 1985.

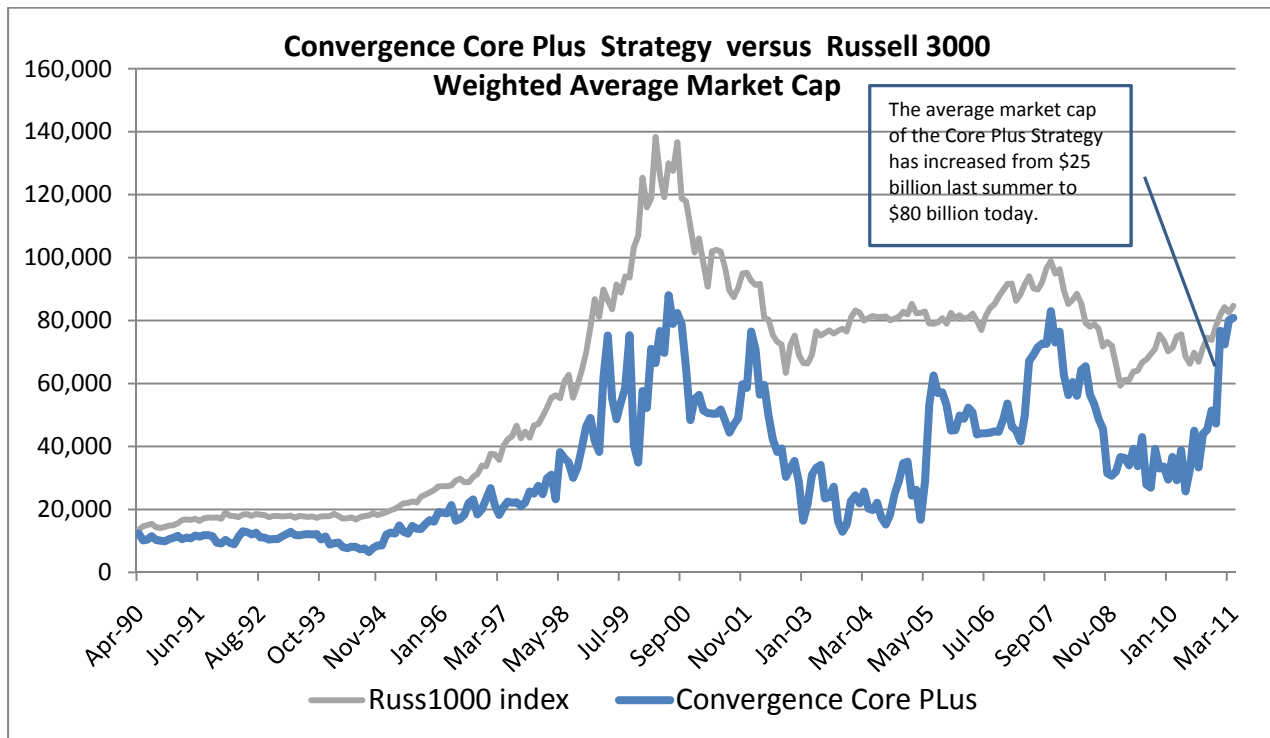


Source: BofA Merrill Lynch Small Cap Research; Russell Investment Group.

With earnings growth rates now slowing, and evidence growing that the economy is at least entering a period in which growth will slow, if not pause, the risk to the market on a short term basis has increased. For the small cap market, this new anxiety is particularly acute.

Dynamic Modeling Responds to Changing Conditions.

The Convergence Core Plus Strategy utilizes our Proprietary Dynamic Model. We measure the relative attractiveness of stocks using a quantitative model that evaluates approximately 70 separate factors, such as price to earnings, price to cash flow, as well as earnings momentum, in the four broad categories of Growth, Valuation, Behavioral, and Risk. The “Plus” is that the model adjusts the weights of the factors within the model depending on market conditions. No better example exists than what is currently taking place relative to market capitalization. Shown below is a comparison between the weighted average market cap of our Core Plus Strategy and the Russell 3000.



The relative attractiveness of small to mid cap stocks coming out of the 2008/2009 collapse drove our average market cap down to \$25 billion. This represented about 35% of the Russell 3000. By the fall of 2010, however, the relative out-performance of small and mid cap stocks and the resulting change in relative valuation caused the model to move the average market cap to near parity to the Russell 3000 today.

While not solely the result of the market cap change, we also note a drop in the predicted tracking error to the Russell 3000. Predicted tracking error has fallen over 60% since last summer. Tracking error is desirable during periods when valuation disparities favor the generation of alpha, particularly through upside variance. During periods when valuation disparities favor the benchmark, tracking error is to be mitigated. The changes driven by the dynamic model reflect an environment favoring large multinational constituents in the index.

The Value in Being Able to Short

The Core Plus mandate loosens an important restriction in a typical portfolio strategy: the ability to short. While we maintain a 100% net long position to invested capital at all times, the ability to short provides an extra tool that at times can be a material source of alpha. Today is such a time.

The discussion above primarily focuses on the market cap change within the long portfolio. While the market cap of the long has increased dramatically over the past 6 months, the short has actually decreased in average market cap. The 30% that we maintain in our short portfolio has an average market cap of just \$3.7 billion. This is of course offset by the added long position. The result is a natural arbitrage set up within the portfolio based on market cap. If, as we expect, large cap stocks out-perform small cap stocks, regardless of the direction of the market, alpha will be added to the portfolio. To view this effect real time, we look to the first few days of May:

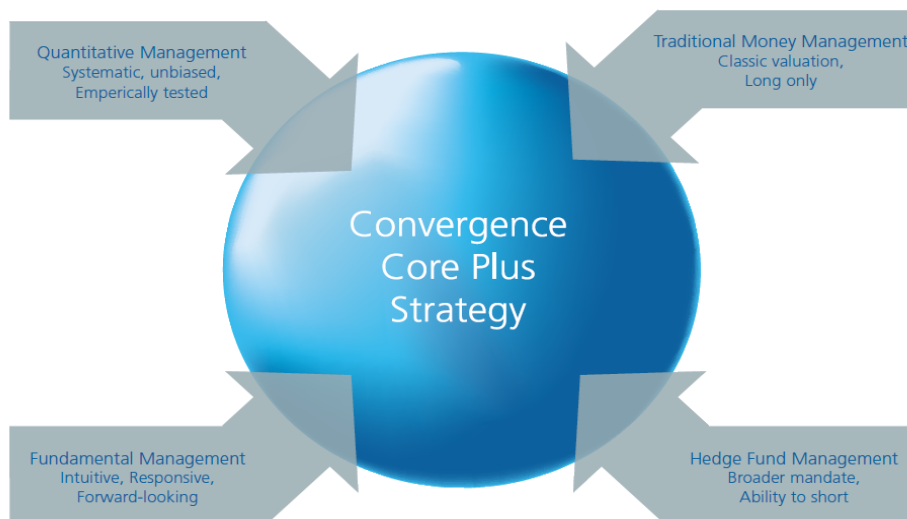
	Convergence Core Plus				
	Total Return	Spread Return Between the Long and the Short	Contribution of the Spread Return	Russell 3000	Russell 2000
5/2/2011	-0.23%	0.39%	0.12%	-0.28%	-1.22%
5/3/2011	-0.56%	0.53%	0.16%	-0.51%	-1.29%
5/4/2011	-0.56%	0.55%	0.17%	-0.75%	-1.29%
5/6/2011	-0.51%	0.08%	0.02%	-0.80%	-0.44%
Month to Date	-1.85%	1.55%	0.46%	-2.32%	-4.18%

As the market retreated in early May, small cap stocks under-performed. The spread return between our long portfolio and our short portfolio amounted to 155 basis points. With 30% committed to the short, the spread return added 46 basis points to the Total Return, enabling the portfolio to out-perform the Russell 3000 by 47 basis points, and the Russell 2000 by 233 basis points.

Four days does not make a horse race, but the composition of the return is instructive. From the August 31, 2010 to April 30, 2011 the Convergence Core Plus Strategy out-performed its benchmark, the Russell 3000, by 987 basis points, in part by exploiting the opportunity available in stocks with a lower market cap. As valuations and market conditions changed, our Dynamic Model adjusted, increasing the market cap, reducing the tracking error, and exploiting the opportunity to short an overvalued small cap market. Add 47 basis points in the most recent reversal.

Bridging Traditional Barriers

Seeking a More Material and Consistent Alpha



Source: Convergence Investment Partners, LLC

QIS ADVISORS LLC commenced operations in November 2004, and became MQS in December 2008, and Convergence Investment Partners (CIP) on February 1, 2011. Actual performance is not meant to be a prediction of future performance. Model performance information and portfolio characteristics about QIS strategies contained in this document are provided solely to demonstrate CIP's investment process. Model performance results are derived from applying CIP's proprietary model to historic market data and do not reflect actual trading activity, and may not reflect the effect of material economic and market factors that might have influenced the adviser's decision making if the adviser had actually been managing clients' money. Model results incorporate all available data for the period covered. To the extent that some data was not available, it was excluded from the model and is not reflected in the model performance. The conditions, objectives, and investment strategies of the model have not materially changed over the period.

Actual results are labeled as "Composite Performance." Composite results are net of fees, and all performance information includes the reinvestment of dividends and other earnings.

Clients having portfolios containing securities other than used for the strategy selected, and portfolios subject to tax, client-imposed or other restrictions, would have had higher or lower returns than the model and actual performance shown. Also, the composition and market volatility of the Russell indices, which are unmanaged market-weighted indices, and the composition and volatility of the portfolios used in the model and actual portfolios are materially different.

Factors such as the size and performance of specific securities positions in accounts, the length of time certain positions are held, the timing of purchases and sales during the reporting period, client objectives, cyclical securities price trends, favorable and unfavorable news pertaining to securities, market trends and other factors all influence performance results materially. For these reasons, actual client account performance for any strategy would only match CIP's model and actual performance results by coincidence. As with all equity investments, there is a risk of loss.

The data used for this report was obtained from sources deemed reliable and then organized by the staff at CIP. Performance calculations were prepared using standard industry software and were not audited by a third party. Errors could have occurred in the data, in the calculations and in the preparation of the report.

Performance information contained herein is not meant to be a historical description of actual results, nor a prediction of future performance. Actual results may vary from the results illustrated herein and such variations may be material. Losses can occur from using any strategy.