

## Portfolio Underperforms as Commodity Prices Decline

Your Small Cap Growth portfolio trailed the Russell 2000 Growth Index during the third quarter as our energy, industrial and material holdings declined. Many of our investments in these areas came under pressure as commodity prices fell, economic growth concerns mounted, and hedge funds liquidated widely-held positions. These losses were mitigated by our stock selection in health care, where a few of our specialty pharmaceutical companies received positive news. In consumer, our focus on recession-resistant companies also contributed to returns.

Year-to-date, the portfolio's relative underperformance of the benchmark has been attributable primarily to our stock selection in industrials, and to a lesser extent in consumer, health care and financials. Despite underperforming during the third quarter, our energy holdings have been the most meaningful contributors through nine months. Our natural gas exploration and production companies in particular have benefited from strong reserve and production growth results.

### Purchases

We repositioned our energy investments during the third quarter following the relative outperformance of natural gas services providers and relative underperformance of independent oil and gas companies. As such, we took advantage of the opportunity to reenter several names we had sold earlier in the year due to price appreciation. These include **Quicksilver Resources**, **Carrizo Oil & Gas**, **EXCO Resources**, and **Goodrich Petroleum**. An additional purchase and beneficiary of

our "Unconventional Resources" theme is **GMX Resources**. These investments further demonstrate our conviction in natural gas exploration and production companies, all of whose business models are fully funded, net asset values have been ignored, and growth profiles remain intact.

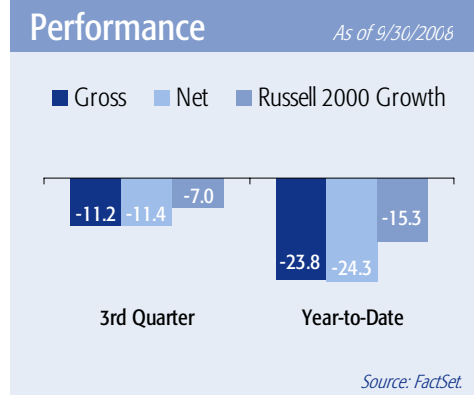
In health care, we added medical device company **ev3** and inpatient services provider **Psychiatric Solutions**. ev3 is nearing the end of its restructuring and turnaround, as management has right-sized its cost structure and repositioned the company in the peripheral cardiovascular disease market. Psychiatric Solutions will benefit from a recent congressional bill requiring health care plans to reimburse patients for mental health treatments on par with physical treatments.

We purchased apparel and footwear designer **Volcom**, which has managed inventories tightly and grown market share. Volcom trades at a compelling value given its robust growth profile.

In financials, we reentered risk manager **FCStone Group**, whose services are likely to experience a sharp demand increase as market volatility is rampant. We also reentered **Orbital Sciences** in industrials, which manufactures aerospace and defense products. Orbital Sciences has strong visibility with improved funding for missile defense.

### Sales

Due to price target attainment, we sold employee spend management provider **Concur Technologies**, educational platform provider **LeapFrog Enterprises**, and aircraft systems developer **AeroVironment**. Concur, in particular, was a long-



standing position in the portfolio with recurrent beat-and-raise earnings announcements.

We exited and took profits from natural gas services providers **Pioneer Drilling** and **Complete Production Services** in favor of independent oil and gas companies. Similarly, we exited high-cost independent oil and gas companies **Delta Petroleum** and **Bill Barrett** in favor of low-cost producers with more attractive risk-reward profiles.

We sold electronic market maker **Interactive Brokers Group** as we grew uncertain about the impact that the current market environment would have on the company's business model. In health care, we eliminated diagnostic systems manufacturer **Abaxis** due to continued poor sales and product development execution.

In pursuit of more attractive risk-reward opportunities, we exited restaurant operator **Red Robin Gourmet Burgers**, internet services provider **Cogent Communications Group** and molecular diagnostics company **Cepheid**.

| Top Ten Holdings                | <i>As of 8/31/2008</i> |
|---------------------------------|------------------------|
| Petrohawk Energy                | 3.9%                   |
| Aegean Marine Petroleum Network | 3.1%                   |
| VistaPrint                      | 3.0%                   |
| Life Time Fitness               | 3.0%                   |
| Huron Consulting                | 2.8%                   |
| Pinnacle Entertainment          | 2.7%                   |
| Intrepid Potash                 | 2.5%                   |
| InnerWorkings                   | 2.5%                   |
| Nelnet                          | 2.4%                   |
| GMX Resources                   | 2.3%                   |
| <b>Total Top Holdings</b>       | <b>28.3%</b>           |

*Source: FactSet.*

| Sector Distribution (GICS®) |                    | <i>As of 9/30/2008</i> |       |
|-----------------------------|--------------------|------------------------|-------|
|                             | Relative Weighting | Portfolio              | Index |
| Consumer Discretionary      | -2.0               | 11.0%                  | 13.0% |
| Consumer Staples            | -0.8               | 2.0%                   | 2.8%  |
| Energy                      | 7.9                | 16.8%                  | 8.8%  |
| Financials                  | -2.2               | 3.0%                   | 5.2%  |
| Health Care                 | -0.3               | 24.5%                  | 24.8% |
| Industrials                 | 3.1                | 21.5%                  | 18.5% |
| Information Technology      | -1.8               | 20.0%                  | 21.8% |
| Materials                   | -2.0               | 1.2%                   | 3.2%  |
| Telecommunications          | -1.2               | 0.0%                   | 1.2%  |
| Utilities                   | -0.8               | 0.0%                   | 0.8%  |

*Based on GICS® Sector Classification. Index: Russell 2000 Growth. Source: FactSet.*

## Outlook

Deteriorating conditions in the financial markets have led to unprecedented bankruptcies, an historic credit crisis, and capital markets that have gone from dysfunctional to nonfunctional. Furthermore, with unemployment at 6.1% and rising, and the threat of a severe global economic slowdown, the countervailing forces in the U.S. economy that were previously central to our no-recession view are no longer strong enough to prevent the economy from a meaningful decline. Given these headwinds, along with continued housing and fuel price concerns, we do expect the U.S. economy to struggle to find its footing and begin a growth trajectory again.

Credit access is pivotal for small-cap companies to outperform. Accordingly, we have maintained our yearlong trend of focusing only on business models that are fully funded through 2009. We are straying from highly discretionary items and overly competitive markets, which are likely to struggle as the consumer remains weak, and also high-cost business models and non-earnings companies, which are unlikely to outperform in a risk-averse market with no available credit. Ultimately, we have focused new capital on those companies whose growth prospects are on balance less affected by a weak economy.

Make no mistake, the central focus of our investment process is, as always, bottom-up stock selection, and our analysis has led us to build a sizable overweighting to energy. Our most notable theme continues to be “Unconventional Resources,” where low-cost, high-growth producers offer both offensive and defensive characteristics. As such, we believe these companies are capable of outperforming in any economic environment. In our view, the companies’ recently announced capital budget cuts guarantee a supply response in the commodity, setting a base for their share prices to outperform.

Our other sizable overweighting is to industrials, where “Transportation Efficiency” has evolved into a prominent theme. During the past few years, industry supply has been significantly reduced as a result of high-cost operators exiting the business. This has created a window of opportunity for lower-cost, higher-quality truckers and airline operators to gain market share and stabilize pricing. Elsewhere in the portfolio, we are very modestly underweight relative to the benchmark. We continue to allocate our capital to our most attractive risk-reward investments while maintaining a balanced, diversified portfolio. Although the current environment can be gut-wrenching, the opportunities we see for outsized returns in select companies over the long term have never been better. Discipline and patience will ultimately prevail.

The information contained herein reflects Oppenheimer Capital's Small Cap Growth Composite. Prior to November 1, 2006, the Small Cap Growth style was managed by a former affiliated adviser which functioned as a separate operating entity within the same holding company as Oppenheimer Capital. The members of the Small Cap Growth investment team were dual employees of Oppenheimer Capital and the former affiliated adviser and are now exclusive employees of Oppenheimer Capital. The performance returns shown prior to November 1, 2006 reflect the composite that was managed by the former affiliated adviser which is now managed by Oppenheimer Capital. The Small Cap Growth (unconstrained) Composite (the “Composite”) differs from the Composite formerly known as the Small Cap Growth Composite. The Composite was created in 1999 and includes all discretionary equity oriented tax-exempt accounts (including mutual funds) with market values of \$5 million or greater managed by OpCap in its Small Cap Growth (unconstrained) strategy. Commencing 1/2005, new accounts are included in the Composite beginning with the first full month under management after they have been fully invested (as determined by OpCap) and terminated accounts are removed at the end of the last full month under management. Prior to 1/2005, new and terminated account were included or removed from the Composite on a full quarter basis. The Composite returns are based upon trade date accounting and include the reinvestment of dividends and interest. Composite returns are asset weighted using beginning of month market values. Prior to 7/1999, Composite returns are calculated using a time weighted monthly linked rate of return formula. Effective 7/1999, portfolios are valued daily and monthly rates of return are calculated by geometrically linking daily rates of return. Quarterly, annual and annualized returns are calculated by geo-metrically linking monthly and quarterly rates of return, respectively. In order to calculate the net performance, the gross performance is reduced by the highest annual advisory fee charged to any account within the Composite. If available, mutual fund monthly rates of return (net) are calculated utilizing the fund's beginning net asset value and ending net asset value and income and capital gain distributions (when applicable). For such funds, gross of fee performance is calculated by taking performance calculated at net asset value and adding back the pro-rated monthly percentage of the total net annual expense ratio (including investment management fee, fund service fee, 12b-1 fee and other expenses). Performance results are expressed in U.S. dollars. Additional information regarding policies for calculating and reporting returns is available upon request. In order to calculate the net performance, the gross performance is reduced by the highest annual advisory fee charged to any account within the Composite (or with respect to Prior Firm performance, the highest annual advisory fee then in effect). Gross of fee performance for mutual fund accounts included in the Compo site is calculated by taking performance calculated at net asset value and adding back the pro-rated monthly percentage of the total net annual expense ratio (including investment management fee, fund service fee, 12b-1 fee and other expenses). Actual account performance will vary depending on the size of a portfolio and the applicable fee schedule. Oppenheimer Capital's current standard fee schedule is contained in Part II of its Form ADV. The characteristics above reflect certain characteristics of the securities held in representative portfolio managed in the small cap growth style and included in the Small Cap Growth (unconstrained) Composite (the “Representative Portfolio”). On any given date, any particular account managed in the Small Cap Growth style may include securities not held by the Representative Portfolio and may not hold each security held in the Representative Portfolio and consequently, may have portfolio characteristics that differ from those of the Representative Portfolio. The characteristics and sector distribution data for the representative account are based on estimated data obtained through FactSet. Source of GICS® Sector Classification: S&P and MSCI. The Russell 2000 Growth Index is a broad measure of the small cap growth style and measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. The Index is referred to for comparative purposes only and is not intended to parallel the risk or investment style of the accounts in the Composite. A list of all recommendations made by Oppenheimer Capital for the Small Cap Growth style for the preceding 12 months is available upon request. It should not be assumed that any of the holdings were or will prove to be profitable, or that the investment recommendations we make in the future will be profitable or will equal the performance of the securities presented in this list. Except as specifically noted, Index data has been obtained from FactSet. The information presented in this Quarterly Review has been developed internally and/or obtained from sources which Oppenheimer Capital believes to be reliable; however, Oppenheimer Capital does not guarantee the accuracy, adequacy or completeness of such information nor does it guarantee the appropriateness of any strategy referred to for any particular investor. 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