



## Investing Through the Market Turn

Over the past few months, the markets have witnessed a profound shift in psychology that has been reflected in significant gains for stocks and continued improvement in the credit markets. Economic conditions, while still depressed, are “less worse” than generally anticipated, suggesting that an economic bottom has been reached. Still, it’s unclear whether the current market surge is sustainable; and, from an asset allocation standpoint, we continue to favor barbell portfolios between relatively defensive assets and more aggressive investments that could benefit from a bullish environment. Here, we assess recent events and note potential long-term challenges as we move further away from an environment of crisis.

### ANATOMY OF A RALLY

Since bottoming on March 9, the Dow Jones Industrial Average and S&P 500 have risen by more than 29% and 35%, respectively<sup>1</sup> — the sharpest post-bear market surge since the 1930s. Although the rate of gains has slowed recently, higher-beta, more economically sensitive sectors (including Financials, Consumer Discretionary, Industrials and Materials) have set the pace.

At one point recently, 80% of stocks on the New York Stock Exchange were trading above their 10-week moving average. This is traditionally considered a “resistance level” and suggests that investors may pause after recent gains, if only to catch their breath and assess whether current earnings prospects justify an additional advance. Of course, a pullback isn’t necessarily a bad thing and may provide an attractive entry point to put money to work.

Unlike the numerous rallies that, over the past year, eventually gave way to new lows, the most recent upturn has been accompanied by widespread improvement in economic fundamentals:

- Consumer confidence has risen sharply, with the Conference Board Consumer Confidence Index moving from a deep low of 26.9 in March to 49.3 in June.
- Manufacturing, as measured by the Institute for Supply Management’s manufacturing index, has risen for six consecutive months since reaching an all-time low last December.
- The pace of job cuts slowed for four of the past five months—a phenomenon that has historically coincided with the end of recessions.

<sup>1</sup> Data through June 30, 2009.

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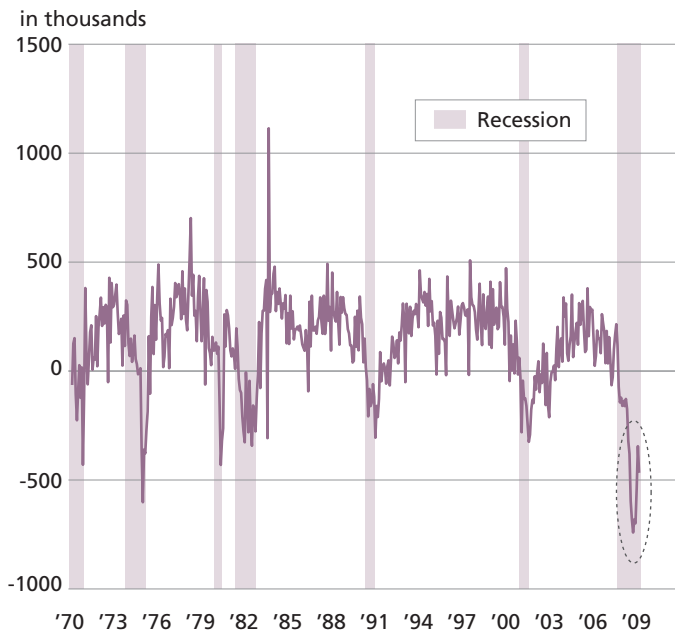
#### CONCENTRATED STOCK: TO SELL OR NOT TO SELL

Matthew L. Rubin

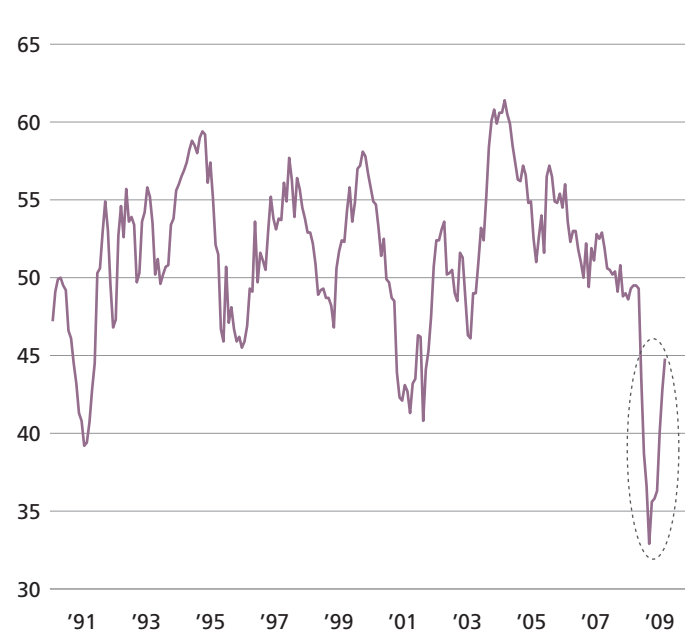
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**FIGURE 1 — IMPROVING FUNDAMENTALS COULD PUT A FLOOR UNDER PROFITS**

**Change in Nonfarm Payrolls**



**Manufacturing Activity: PMI Composite Index**



Source: Bureau of Labor Statistics, St. Louis Federal Reserve, Institute for Supply Management. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. Past performance is no guarantee of future results.

- Borrowing costs, reflected by LIBOR (London Interbank Offered Rate) and mortgage rates, have declined to historical lows, easing some pressure on businesses and consumers.
- Stock market volatility has softened, with the Volatility Index (VIX) dropping below 30 for the first time since last September.

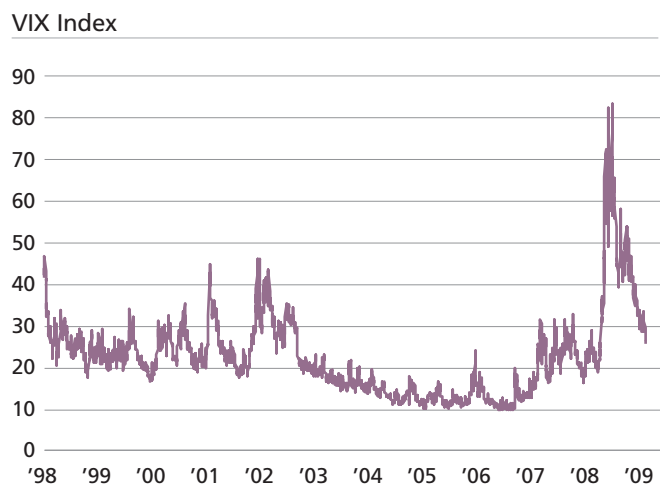
The advances in the stock market off March 9 lows also demonstrate that massive government interventions have achieved their most fundamental goal—to avoid an economic calamity. The number and intensity of interventions has been extraordinary: the Troubled Asset Relief Program, the Financial Stability Plan, the Public-Private Investment Fund, the federal stimulus package, multiple bailouts, unprecedented involvement in the auto industry and near-zero interest rates are among the key initiatives policymakers have implemented. These efforts stabilized the financial system, effectively avoiding a “financial Armageddon.” We expect government involvement in the sector to diminish going forward.

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**A TOUGH ROAD**

Still, the path for the economy from here will likely be difficult. The prosperity of recent years was built on the increased use of debt by consumers. With the sharp reduction of household wealth (due in large part to lower housing prices and investment losses), as well as stricter limits on credit, consumers are likely to enter a period of retrenchment and deleveraging. Consumption, which peaked at 71% of GDP

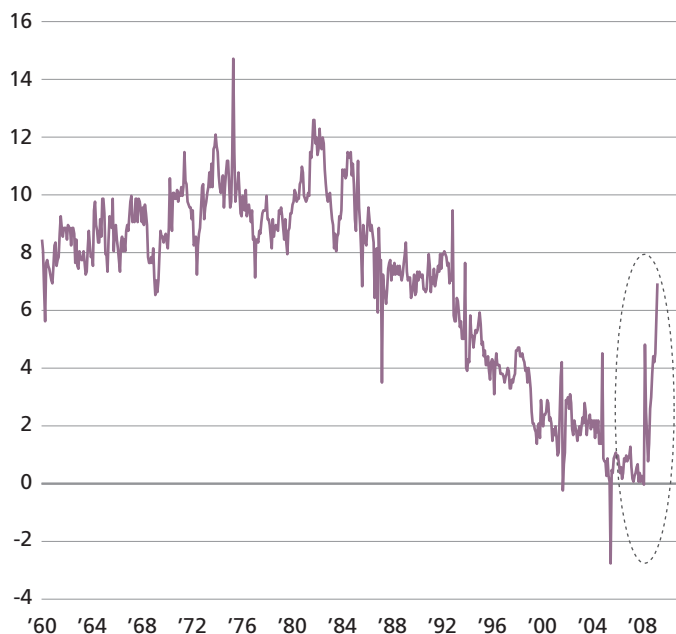
**FIGURE 2 — VOLATILITY HAS LESSENER SINCE PEAKING LAST NOVEMBER**



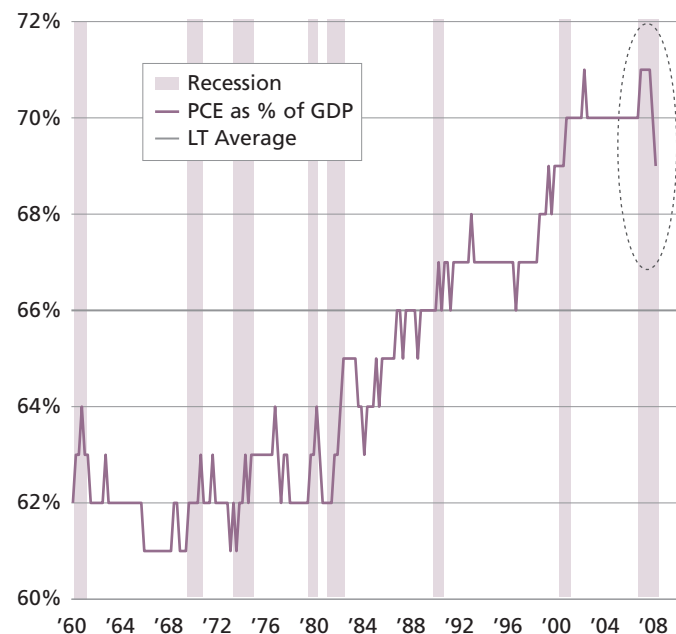
Source: Merrill Lynch. Data as of June 30, 2009. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. Past performance is no guarantee of future results.

**FIGURE 3 — HOUSEHOLD CONSUMPTION REDUCTION**

Household Savings Rate as % of Disposable Income



Private Consumption as % of GDP



Source: Bureau of Economic Analysis, J.P. Morgan.

in September 2008, has steadily declined, reaching levels as low as 69% as of March 31, 2009. Ongoing debt reduction by financial institutions and businesses could also have a dampening effect. All together, these factors could keep economic growth muted for some time.

We are also cognizant of the danger of inflation. Over the last few months, the federal budget deficit and Federal Reserve balance sheet have quickly expanded to fund the government initiatives noted above. While these actions have been constructive for the financial markets and economy, the prospect for a weaker dollar and higher borrowing costs remains real. We do not see inflation as a near-term threat due to the rising unemployment rate and decline in consumer spending. However, we are concerned about long-term inflation and how the value of the dollar is being reduced to inflate our way out of a weak economic environment. Recent declines in Treasury prices suggest an increased risk appetite, but also a renewed perception of inflation dangers.

### THOUGHTS ON STRATEGY

Based on first quarter earnings, an improvement in economic fundamentals and a decline in volatility, we believe we have reached a trough in the profit cycle and may be entering a bull market that could last multiple years, supported in the near term by government stimulus and a return to earnings

and economic stability. Investment segments that tend to outperform during a market recovery — lower-quality, smaller-cap, cyclical and other higher beta stocks — have led the current market rally. Some exposure to these areas could help position investors to participate in an upswing.

*We do not see inflation as a near-term threat due to the rising unemployment rate and decline in consumer spending. However, we are concerned about long-term inflation and how the value of the dollar is being reduced to inflate our way out of a weak economic environment.*

However, the economic headwinds noted above and the ongoing deleveraging process could produce a low-growth environment going forward. Companies that can achieve steady revenue and unit growth—typically larger, more conservative companies—have the potential to do well. To limit the risk of mistiming the economic and profit cycles, we favor pairing low-beta and high-beta investments together, depending on an individual's objectives and risk tolerance. As always, the research orientation, investment discipline and perspective offered by our managers could be highly valuable in navigating the markets — now and in the future.

In each *Investment Quarterly*, we seek to highlight investment and planning ideas that may be of use to our clients. In this edition, Michelle Stein, a senior portfolio manager in our KSE Value group and a veteran of our firm, provides a window into her investment approach and how cash can be used effectively within a long-term equity strategy. Additionally, Director of Investment Strategy Matthew Rubin considers potential ways to deal with concentrated stock positions. We hope you will find the contents of our newsletter useful; please let us know if there are topics you would like us to cover in the future.

On a final note, I want to recognize the contribution of Alison Deans, former Chief Investment Officer and Head of Equity Research, who has decided to leave the firm to start her own investment advisory business. For more than five years, Alison has brought energy and focus to everything she has done at the firm. Moving forward, I will be assuming Alison's CIO and research duties, while providing business and risk management oversight to our portfolio management teams. It is a role I look forward to with great excitement as Neuberger Berman once again charts a course as an independent, employee-controlled investment firm. ■



**JOSEPH V. AMATO**

PRESIDENT, CHIEF INVESTMENT OFFICER—EQUITY  
**NEUBERGER BERMAN**

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# Why We Use Cash in our Equity Portfolios



**MICHELLE B. STEIN**  
SENIOR PORTFOLIO MANAGER  
KSE VALUE GROUP

The market volatility of the last year has caused investors and the media to question longstanding investing principles, from whether asset allocation works to whether fixed income is a better long-term investment than equities. Over time, we’ve seen that cash is a recurring theme in many investing discussions. When the market is falling, investors tend to lament holding too little. When the market rebounds, they often can’t escape it quickly enough. As an equity portfolio manager for whom cash is an integral part of our investment strategy, we follow these discussions with particular interest. For more than 20 years, we feel our approach to cash has contributed to the risk-return balance of our portfolios. It is considered by some to be a non-traditional approach to equity investing, but one that, we feel, offers potential rewards and warrants discussion.

## THE MYTH OF THE FULLY INVESTED PORTFOLIO

Clients occasionally ask why we as an equity manager don’t run our portfolios “fully invested”—with 100% of assets invested in equities—all of the time. It’s a fair question: After constructing an asset allocation that devotes a portion of a portfolio to equities, there’s generally an expectation that those assets will, in fact, be fully invested in stocks. However, we believe the idea of a fully invested, professionally managed portfolio is not necessarily optimal, particularly for a high net worth investor. It depends in part on whether you are focused on relative returns or total returns.

Investors with a relative return focus seek to outperform a specified benchmark. This approach has been driven primarily by institutional investors who invest substantial assets across a broad array of asset classes. After assessing

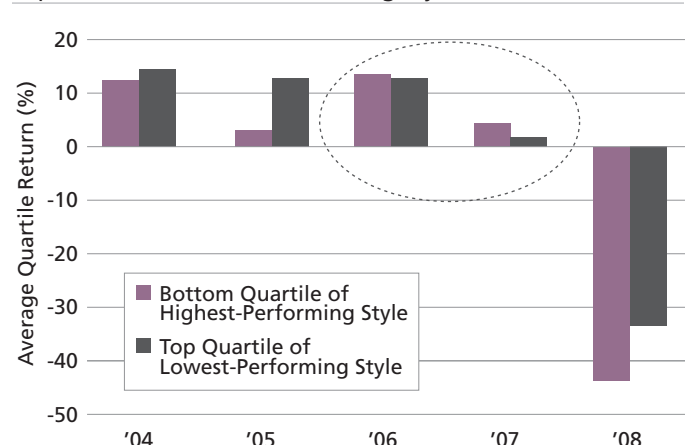
**FIGURE 1 — BEING UNCONSTRAINED BY STYLE HAS ITS BENEFITS**

There is often a significant performance disparity between style groups; style-based constraints can be very difficult to overcome.

### Historical Style Performance

Year	Morningstar Style		Return Difference
	Highest-Performing	Lowest-Performing	
2008	Large Core	Mid Growth	14.8%
2007	Mid Growth	Small Value	27.9%
2006	Large Value	Large Growth	20.1%
2005	Mid Growth	Large Growth	12.8%
2004	Mid Value	Large Growth	24.1%
2003	Small Growth	Large Core	27.9%
2002	Small Value	Small Growth	28.6%
2001	Small Value	Large Growth	47.6%
2000	Mid Value	Large Growth	58.1%
1999	Mid Growth	Mid Value	59.3%
1998	Large Growth	Small Core	58.8%

Bottom Quartile of Highest-Performing Style vs. Top Quartile of Lowest-Performing Style



Sources: Neuberger Berman; Morningstar.

Style group data is based upon Morningstar mutual fund style categories. Style group data is based upon Morningstar mutual fund style universes. Style returns shown are based on the average returns of the funds in the Morningstar style universe or universe quartile. Morningstar ratings and averages are ©2009 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Unless otherwise indicated, returns are shown net of fee and reflect reinvestment of dividends and distributions. Investing entails risks, including possible loss of principal. Past performance is no guarantee of future results.

the potential returns and risk of each underlying asset class, they generally create specific allocations and use this information to build a target return for the whole portfolio. Once institutions set their asset class exposures, they tend to outsource investing to different portfolio managers and constrain them by sector weights, geography, market capitalization and other criteria to keep the portfolio asset exposures properly aligned. Managers seek to outperform the index for their particular asset class but, in general, are more heavily penalized for underperformance than they are rewarded for outperformance. While a manager may find some “comfort” in a fully invested portfolio that performs in line with a particular benchmark, investors could in fact be limiting their return potential and increasing their susceptibility to a style-specific drawdown (see Figure 1).

The relative return asset allocation model may also not be ideal for individual investors for a few reasons. First, individuals generally have less to invest than institutions and cannot diversify as effectively across a wide range of

highly specific asset classes. Further, investments often represent a significant part of an individual investor’s net worth. For this reason, many individuals have a lower tolerance for volatility than institutions and, as history has demonstrated, may make emotion-based investment decisions leading to ill-timed asset allocation changes that contribute to declining portfolio value (see Figure 2). Given

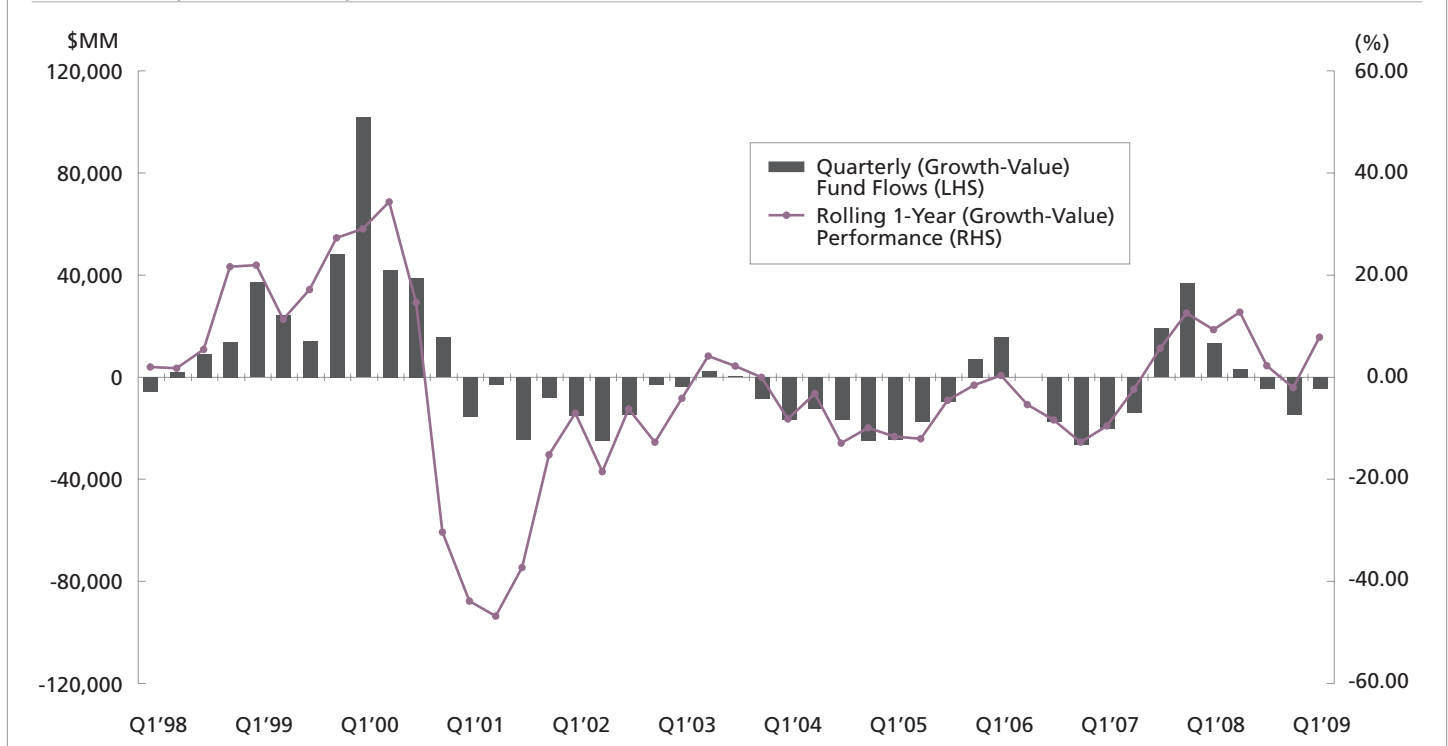
*Conceptually speaking, we tend to choose cash over an equity position when its risk-reward profile—no downside and very limited upside—is comparatively more attractive from a total return standpoint than any other potential investments.*

that individuals tend to place a greater emphasis on wealth preservation, it may be prudent to invest with a total return focus. Total return investors differ from relative return investors in that they generally attempt to build portfolios based on performance goals or risk levels and look to maximize the long-term value of their investment. Because

**FIGURE 2 — INDIVIDUAL INVESTORS ARE PRONE TO MARKET TIMING MISTAKES**

Investors succumb to behavioral traps, tending to buy high and sell low. In 2000, for example, net inflows of growth funds compared to value funds peaked right around the height of growth fund outperformance over value funds.

Fund Flows by Investment Style vs. Performance



Source: Morningstar. Includes all U.S. growth and value mutual funds. Style group data is based upon Morningstar mutual fund style categories. Style group data is based upon Morningstar mutual fund style universes. Style returns shown are based on the average returns of the funds in the Morningstar style universe or universe quartile. Morningstar ratings and averages are ©2009 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Unless otherwise indicated, returns are shown net of fee and reflect reinvestment of dividends and distributions. Investing entails risk, including possible loss of principal. Past performance is not indicative of future results.

total return investors are not necessarily tethered to an index, they often have significant flexibility to pursue returns through a wide range of methods including running portfolios that are less than fully invested.

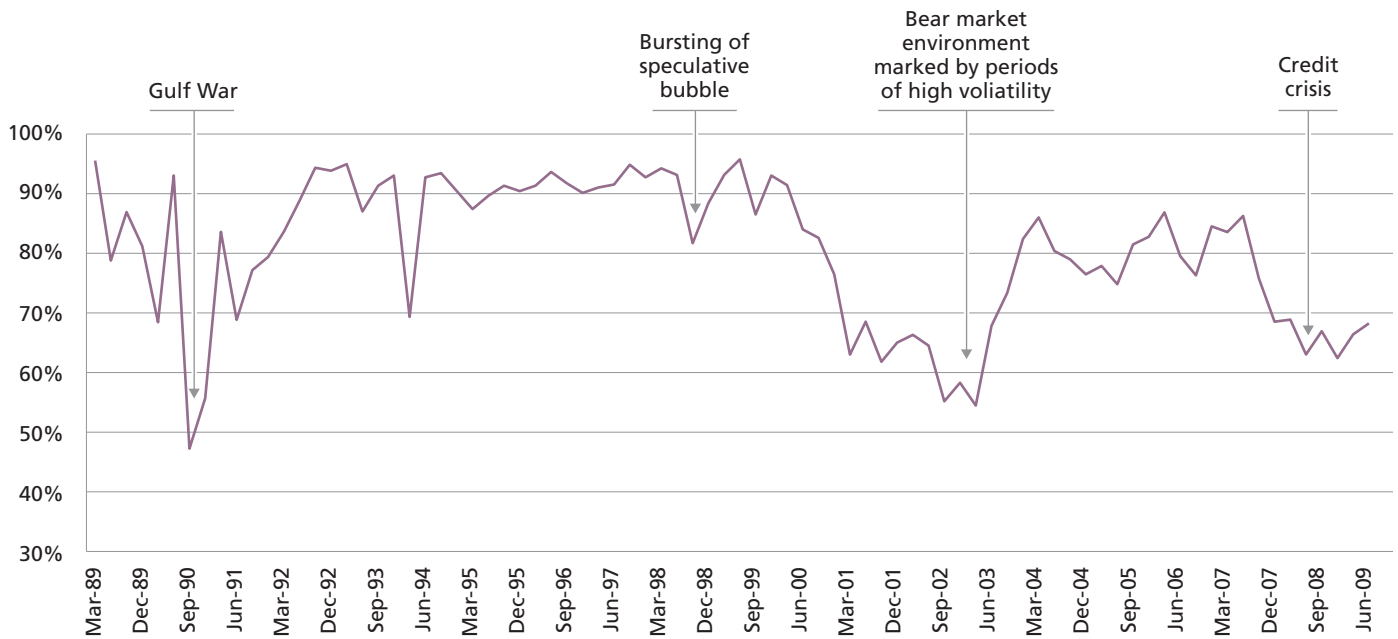
### CASH CAN BOOST LONG-TERM EQUITY RETURNS

Over the life of our KSE Value Strategy, our portfolios have ranged from being fully invested to holding as much as 52% in cash and we think of it as both a default position and an active investment position. Conceptually speaking, we

**FIGURE 3 — CASH POSITION CAN HELP RISK-REWARD BALANCE OVER MARKET CYCLES**

KSE Value Strategy cash positions tend to be higher when markets are volatile or opportunities are scarce. We believe our cash position has contributed positively to our risk-return profile over market cycles.

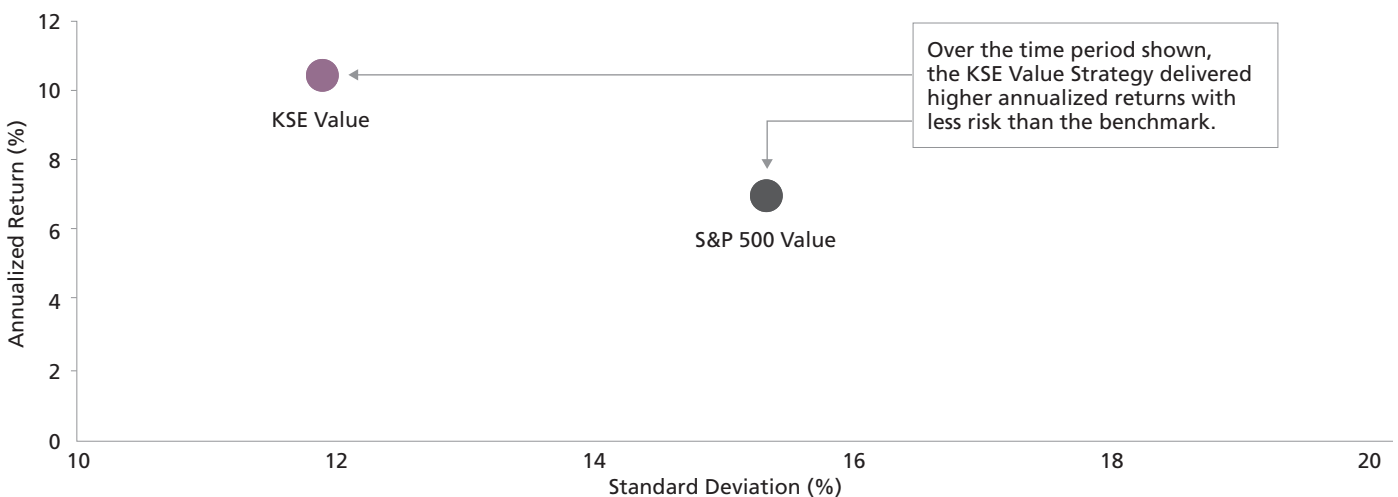
KSE Value Quarterly Equity Exposure as % of Total Assets



Source: Neuberger Berman.

The data represents the quarter-end equity securities allocation of the KSE Value Group composite. Representative strategy characteristics are based upon the manager's composite or a representative composite account, and are subject to change without notice. Client accounts are individually managed and may vary significantly from representative strategy information.

**KSE Value Risk/Return vs. S&P 500 Value (20 years ending June 2009)**



Source: Callan Associates.

Past performance is no guarantee of future results. Please refer to the attached GIPS® compliant composite statement for complete performance information. Client accounts are individually managed and may vary significantly from composite performance information. Indexes are unmanaged and are not available for direct investment. Unless otherwise indicated, returns reflect reinvestment of dividends and distributions. Investing entails risks, including possible loss of principal.

## UNCONSTRAINED INVESTING: THE ESSENCE OF ACTIVE MANAGEMENT

Individual investors who work with active portfolio managers generally do so to benefit from a manager's particular insight into the market and equity investing. Putting constraints on active managers, whether it is a requirement to be fully invested, adopt a sector weighting that mirrors an index or restrict investments by geography, may compromise their strategy, potentially affecting their ability to act on their insights to the detriment of performance.

In our experience, being unconstrained—particularly as it concerns our flexible approach to cash—has benefits. Our strategy tends to identify companies that investors may perceive as “boring” with a potential catalyst that may accelerate earnings growth or effect a positive change in investor perception. Regardless of market conditions, we “stick to our knitting,” focusing on stock picking and fundamentals, and investing in companies that match our criteria. As a result, the number of potential investment opportunities fluctuates over a cycle.

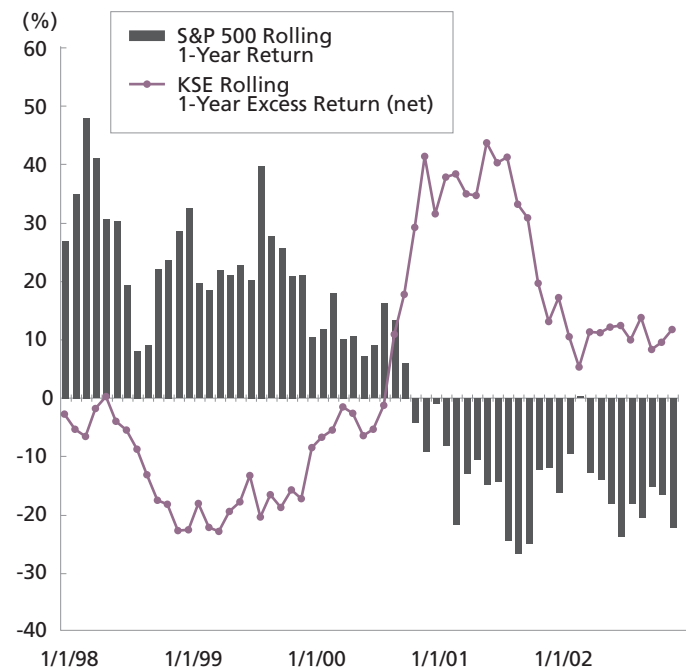
The effects—both positive and negative—of holding varying levels of cash over a market cycle can be demonstrated through the historical performance of our KSE Value Strategy. In 1998 and 1999, during the lead up to the tech bust, we felt that opportunities that met our criteria were scarce and our performance trailed. Instead of investing in tech stocks, which we felt were generally overvalued and lacked catalysts, we sought opportunities in areas like defense which, at the time, were largely overlooked. Between 2000 and 2002, after the tech bubble burst, our cash position and defense sector

stocks helped our portfolio outperform its benchmark significantly, a testament to the strength of our process.

### RELATIVE PERFORMANCE OVER SINGLE MARKET CYCLE

Rolling one-year excess returns of KSE Value Strategy show how strategy underperformed during dot-com boom but outperformed after the bubble burst.

KSE Value vs. S&P 500



Source: Callan Associates. Past performance is no guarantee of future results. Please refer to the attached GIPS® compliant composite statement for complete performance information. Client accounts are individually managed and may vary significantly from composite performance information. Indexes are unmanaged and are not available for direct investment. Unless otherwise indicated, returns reflect reinvestment of dividends and distributions. Investing entails risks, including possible loss of principal

tend to choose cash over an equity position when its risk-reward profile—no downside and very limited upside—is comparatively more attractive from a total return standpoint than any other potential investments.

In a market where we find numerous stocks that match our investment criteria, our cash position tends to be small. In a market characterized by declining fundamentals, where attractive opportunities are scarce, our cash position has historically been significantly larger. Over market cycles, our cash position has been a major contributor to our ability to deliver what we believe is an attractive performance track record with less volatility than the larger market (see Figure 3). But the benefits of cash go further.

### Flexibility to buy and sell at will

Having the flexibility to hold cash can enhance a portfolio manager's ability to consider each investment decision based only on its merits. Managers who are fully invested, on the other hand, generally must decide which position or positions to sell or trim in order to raise funds for a new investment. This can be a time-consuming endeavor, with potential tax consequences for clients; it can also potentially compromise a manager's investment process and dilute the value they bring to the table.

A flexible investment mandate may also offer benefits when it comes time to sell. Portfolio managers tend to have clearly defined, rigorously executed sell disciplines. When deciding to sell or trim a position, those not tied to a fully invested model

may again have an advantage because their decisions are generally unencumbered by an immediate need to reinvest the assets in another equity position. This unlinking of buy and sell decisions has the potential to improve equity performance over time; the cash position can allow each investment idea to stand on its own, without regard to the rest of the portfolio.

### Asset protection in a declining market

A cash position can also provide benefits in a down market due to the compounding effect on returns. First, a cash position can cushion a portfolio's decline: Because gains and losses are asymmetric—a 50% drop in portfolio value requires a 100% gain to recover—limiting the decline can be a highly effective technique for long-term wealth preservation and growth.

*Over market cycles, our cash position has been a major contributor to our ability to deliver what we believe is an attractive performance track record with less volatility than the larger market.*

Further, holding a healthy cash position, particularly in a down market, may allow a manager to add a stock position without dramatically increasing the risk profile of the portfolio. For example, if we find a stock that matches our investment criteria and has fallen significantly from its recent highs, having a high cash position could serve two purposes: First, it could eliminate the need to sell an existing stock position to purchase the new stock. Second, if we felt the stock was priced well below its intrinsic value with attractive long-term potential, but still believed that ongoing volatility may persist with the potential for further declines, the cash position would serve as a buffer that could potentially dilute the impact of additional negative performance on the overall portfolio.

Is there a potential downside to holding cash? Of course. While cash can help protect a portfolio during a downturn, it can also hinder performance during an upswing. Our KSE Value portfolios have tended to trail the market during the early stages of a rebound as the cash position had a drag effect during periods of positive performance. As we

identified opportunities and became more fully invested, the drag effect tended to decrease. Longer term, however, due to the compounding of returns over time we believe that cash is an important factor in our total returns.

### RECONCILING THE CONCEPT OF CASH WITHIN AN EQUITY ALLOCATION

When looking at an overall asset allocation, it can be tempting to count the cash included in an equity portfolio as part of the cash or short-term investment portion of the allocation. After all, equities are equities and cash is cash. We think of it differently. When cash is employed as a tool by an equity manager, the levels in a portfolio tend to fluctuate and become an integral component of the equity strategy. Removing “seemingly excess” cash from an equity portfolio to serve short-term needs would alter the portfolio's strategy as well as its risk-return profile and total return potential. We think of cash as an actively managed position, as essential as any equity position. While we may maintain high cash levels as part of our strategy, the cash we maintain is not intended to satisfy a client's cash needs as part of their overall asset allocation.

This “cash-as-equity” philosophy may require a mindset shift for an investor accustomed to a fully invested approach to equities. However, we feel the previously discussed risk-mitigation potential of cash can make equity investing more palatable to an individual investor, particularly one coming out of the extraordinarily volatile down market we've just experienced. In the end, we believe it is appropriate to compare the total portfolio returns over market cycles of equity managers with a cash component vs. managers running fully invested portfolios. A manager with the flexibility to include a cash position in the portfolio has the potential to deliver a less anxiety-provoking equity investing experience. ■

*Michelle Stein is a senior portfolio manager with the KSE Value Group, which offers an all-cap value strategy. She joined Neuberger Berman in 1979 and has 30 years of industry experience.*

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Representative portfolio information (characteristics, holdings, weightings, etc.) is based upon the manager's composite or a representative composite account. Representative accounts are selected based on such factors as size, length of time under management and amount of restrictions. Client accounts are individually managed and may vary significantly from composite performance and representative portfolio information. **Please refer to the attached GIPS® compliant composite presentation for complete performance information.**

Please see disclosures at the end of this material, which are an important part of this article.

# Concentrated Stock Positions: To Sell or Not to Sell?



**MATTHEW L. RUBIN**  
DIRECTOR OF INVESTMENT STRATEGY  
NEUBERGER BERMAN

When one stock accounts for much of your wealth, it can often be an indication of success, whether achieved through business or investment. While there are many examples of individuals attaining significant wealth through single stock positions, large concentrated holdings can carry significant risk. This leaves single stock investors with a decision to make: hold the position or sell it and diversify?

Both approaches have their merits. For example, investors with very low basis stock positions can face daunting tax costs at sale, which may need to be evaluated along with other financial and business considerations. At the same time, the power of diversification should not be underestimated. Studies have shown that, over time, a diversified portfolio is likely to deliver lower volatility and superior risk-adjusted returns than the average single-stock portfolio. Over a shorter period, a diversified portfolio can more effectively protect you from a sharp downturn in individual stocks or sectors.

Given the potential stakes, it makes sense to evaluate your choices carefully with your advisors and come to an informed decision based on your full financial picture. In the following pages, we seek to aid in that process by laying out some of the issues you may face and exploring a number of strategies that may help you achieve your goals effectively.

## WHEN HOLDING THE STOCK SHOWS APPEAL

As advocates of asset allocation, we often recommend that clients consider selling their concentrated positions and reinvesting the proceeds in a diversified portfolio. For various reasons, that recommendation can trigger a negative response. From a purely financial perspective, selling a position with a low cost basis can be expensive. Currently, the federal long-term capital gains tax rate is 15%, a historical low; however, it still represents a significant portion of the gain on a low basis position. For example, selling a \$20 million position with no tax basis could result in a \$3 million tax liability before potential state taxes are

taken into consideration—a difficult pill for many investors to swallow.

### SINGLE STOCK POSITIONS POSE SIGNIFICANT DOWNSIDE RISK

The overwhelming majority of companies represented in the S&P 500 Index experienced at least one period of negative-to-sharply-negative performance between the market peak (October 9, 2007) and subsequent trough (March 9, 2009). This could indicate that, over time, holding a large stock position in virtually any public company may jeopardize your wealth.

From Peak to Trough Had Returns Worse Than	Percentage of Companies in S&P 500
-10%	97.8%
-20%	96.8%
-25%	96.6%
-33%	94.2%
-50%	80.2%
-66%	51.9%
-75%	36.3%
-90%	13.2%

Source: FactSet.

Note: Includes all companies in the S&P 500 Index on October 9, 2007.

Also worth considering is the step-up in basis to the current market value that the stock may receive when transferred to beneficiaries upon your death. This could effectively eliminate the capital gains tax liability for your heirs, provided they sell immediately after receiving the step-up in basis. Many families wait to sell for this very reason. Any future increase in the capital gains tax may make this strategy even more appealing.

In addition to the potential tax liability associated with a sale, there is also opportunity cost, represented by the stock's future return potential versus that of a diversified portfolio. While the performance of your concentrated stock is not guaranteed, neither is the performance of the investments in which you may redeploy the proceeds of the stock sale. Should your diversified portfolio underperform the stock,

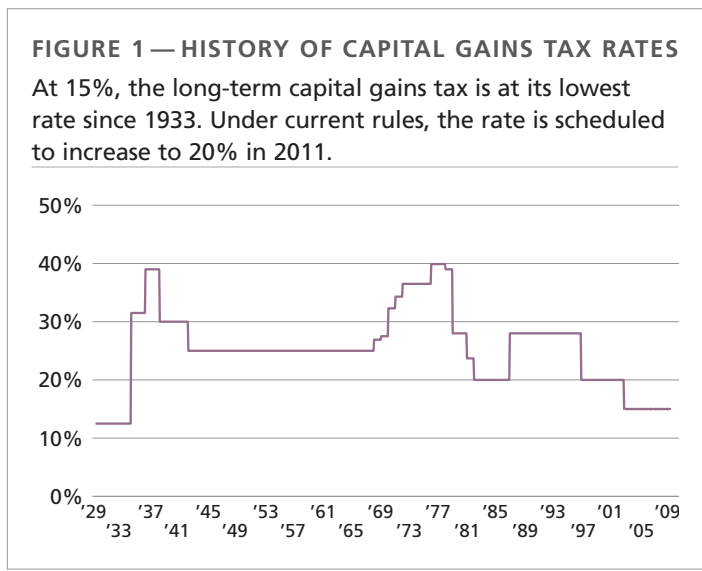
you may regret the decision to sell. When you consider that a diversified portfolio would already be starting at up to a 15% deficit due to the tax cost of the sale, holding onto the concentrated position may seem even more attractive.

*From a purely financial perspective, selling a position with a low cost basis can be expensive.*

Numbers, however, are only one part of the equation. Many holders of large single stock positions resist selling for reasons that are less tangible. Some, for example, are concerned about how shareholders will perceive a sale and/or worry that a sale may trigger a wider sell-off. Others may feel bound to their stock by strong psychological ties. Investors with a personal connection to the company such as founders or their descendents may find the idea of a sale emotionally untenable. While it may not always be possible to factor in the financial implications of these concerns, they are no less valid in contemplating the potential choices.

### THE UPSIDE OF SELLING THE POSITION

From a tax perspective, negative market performance over the last two years may have created an opportunity for a cost-effective sale. With the general decline in stock prices, investors may find themselves sitting on positions that are now trading below the initial cost basis, enabling them to diversify by harvesting losses to offset any realized or future capital gains. With long-term capital gains taxes set to rise from 15% to 20% in 2011, gains taken next year or beyond could prove more costly, potentially increasing the value of losses taken now (see Figure 1).



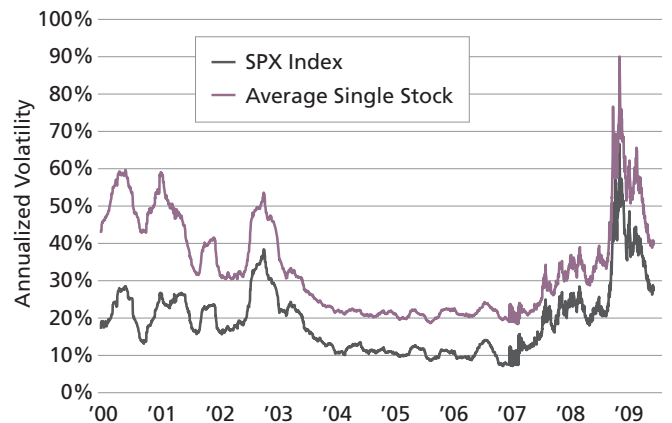
Source: U.S. Treasury Department.

Current circumstances aside, the potential risk reduction associated with selling and diversifying is often the primary and, certainly, most intuitive reason that most investors consider a sale. You needn't look far to find examples of individual companies or entire sectors that, after a good run, have experienced a sharp downturn. The recent dislocation in the financial sector is a perfect example, with the stocks of many firms losing all or a substantial portion of their value over a relatively short period of time. Reaching further back, the dot-com bust spelled disaster for many investors who had bet heavily on the tech sector in the late 1990s.

Leaving aside the issue of actual loss, historically speaking, a single stock tends to experience much higher volatility than a diversified portfolio of stocks. This means that, over time, your concentrated wealth may be more likely to experience dramatic fluctuations in value. (See Figure 2.) For many investors, this kind of exposure simply isn't consistent with their risk tolerance.

**FIGURE 2 — VOLATILITY OF THE AVERAGE SINGLE STOCK IS HIGHER THAN THAT OF THE OVERALL MARKET**

Because individual stocks behave differently from each other over time, a portfolio of stocks (such as the S&P 500 Index) may be less volatile than its component holdings.



Source: Barclays Capital.  
Note: Realized volatility for the S&P 500 is calculated for a rolling 3-month window as the annualized standard deviation of daily log returns. The weighted average realized volatility for the constituents is calculated by weighting the individual 3-month realized volatilities by the respective market capitalizations going back in time.

Time horizon also plays an important role when considering volatility. Over longer periods, equities have historically produced positive returns. Over shorter periods, equity results can be inconsistent. For this reason, those with only a few years to invest may be counseled to include other asset classes such as bonds in their portfolios. Because single stock positions tend to be more volatile than diversified

equity portfolios, shorter time horizons are often even more dangerous to investors with concentrated wealth.

In addition, selling a large single stock position offers the potential to create a more optimal balance between risk and return, potentially enhancing what is known as “portfolio efficiency.” Improving portfolio efficiency through a sale generally entails reinvesting the proceeds in a selection of investments that improves the risk-reward profile, for example, a combination of securities that offers the same or lower volatility along with equal or higher potential returns. While future efficiency can’t be estimated with certainty, an analysis of the potential volatility and returns of a single stock versus a diversified asset allocation (that takes into account the costs associated with diversifying) can provide a reasonable estimate as you think through the decision.

*Time horizon also plays an important role when considering volatility. Over longer periods, equities have historically produced strong positive returns.*

## OPTIONS FOR DEALING WITH A SINGLE STOCK POSITION

Fortunately, the decision to keep or sell a single stock position doesn’t have to be an all-or-nothing proposition. From a financial perspective, you may determine that selling a percentage of the stock can sufficiently protect you from volatility and adequately minimize capital gains taxes. If you would prefer to keep the entire position, certain strategies offer the potential to help you protect a portion or all of its value for a period of time. Whatever you decide, consider working with your Neuberger Berman representative to help ensure that the rest of your assets are positioned defensively against the possibility of a decline in the price of your concentrated stock holdings. For example, allocating your non-single-stock investments to asset classes that have a low correlation to the stock market or that can provide steady income may put you in a better position to achieve your financial goals.

## SELLING ALL AT ONCE OR A LITTLE AT A TIME

Many investors decide that an outright sale of most of their concentrated position makes the most sense from a risk management standpoint. If your position is unrestricted and you are comfortable with the idea, selling the entire block and reinvesting the proceeds in a diversified portfolio can often be your safest choice. Assuming the sale receives long-term capital gains treatment and you reinvest in a

well-diversified portfolio, this solution may also turn out to be the one that provides the best long-term results.

If the idea of selling all the concentrated holding is unpalatable, you might consider selling small amounts over time. A gradual sale of shares over an extended period may appeal to investors who hope to minimize the impact of the trades on shareholder perception and the company’s stock price. This strategy also enables investors who are bullish on their stock to continue to participate in its performance while seeking to protect a gradually increasing portion of their wealth through diversification. When selling a concentrated position over time, one way to limit tax costs is to segment your portfolio by tax lot. Tax lots identify the taxable purchase date and price for smaller blocks within a large stock position. As an ongoing strategy, selling off some of the high-cost tax lots in a portfolio can effectively establish a stepped-up cost basis in the concentrated position.

*The decision to keep or sell a single-stock position doesn’t have to be an all-or-nothing proposition.*

Despite the risks, there will always be individuals who are determined to hold onto as much of their concentrated stock position as possible. These investors may wish to consider selling just enough to sustain their current lifestyle in the event the stock price drops precipitously. Depending on your lifestyle needs, for example, selling half of a \$20 million concentrated position and reinvesting the proceeds in globally balanced, diversified portfolio may provide enough cash flow to cover living expenses. That way, your lifestyle may not be compromised in the event of a significant decline in the remaining \$10 million invested in the stock.

## HEDGING YOUR POSITION UNTIL SALE IS POSSIBLE

If a sale is not desirable or possible for a period of time—for example, if you hold restricted stock or want to make the transition from short-term to long-term capital gains treatment before selling—you may opt to use derivatives such as options or forward contracts to hedge the value of the stock. Investors frequently turn to derivatives, which are so named because they ‘derive’ their value from the underlying instrument, to protect the value of the stock for a period of time until a sale is appropriate. Your Neuberger Berman representative can work with you to determine whether a hedging solution is appropriate for your needs.

## CONTRIBUTING YOUR STOCK TO CHARITABLE TRUST

Charitable remainder trusts are an option for investors with a strong charitable intent who also want to retain a significant financial benefit from their concentrated positions. Here's how these structures work: In most cases, you contribute a portion of your stock position to a charitable trust. Because the contribution is considered a taxable gift, you receive an income tax deduction equal to the value of the contributed stock. Meanwhile, the charitable trust can sell the position and reinvest the proceeds in a diversified portfolio without triggering an immediate capital gains tax liability. During the life of the trust, you will receive regular payments from the trust (either a percentage of the assets or a fixed amount), after which any remaining assets will pass to the charity of your choice.

Depending on certain parameters such as the duration of the trust, the investments selected and the amount the trust pays out each year, the strategy may deliver substantial wealth back to you in addition to creating a significant charitable gift. In rare cases, a charitable remainder trust may even generate more wealth over a long time horizon than a straight sell-and-diversify strategy, due in part to the capital gains tax hit you could take by selling stock outright. This scenario will become more likely if capital gains tax rates increase substantially. That said, this strategy is often less preferable to an outright sale for individuals without a strong charitable intent.

*Charitable remainder trusts are an option for investors with a strong charitable intent who also want to retain a significant financial benefit from their concentrated positions.*

## CONSIDERING YOUR CHOICES

The decision to hold or sell all or a portion of a single stock position is a complex one. While the general arguments for various approaches are compelling, they should be carefully weighed in light of your overall financial situation as well as other relevant financial, business and emotional considerations. Given the range of strategies available for dealing with a single stock position that can be used independently or in combination, your options for handling your own position are relatively wide open. In conjunction with your external advisors, your Neuberger Berman representative can be an indispensable resource during your decision-making process by helping you create financial analyses that demonstrate a variety of potential scenarios. With this clear framework in place, you can put yourself in a position to make informed decisions that will increase your likelihood of achieving your financial goals. ■

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The views expressed herein are generally those of Neuberger Berman's Investment Strategy Group (ISG) which analyzes market and economic indicators to develop asset allocation strategies. ISG consists of five investment professionals and works in partnership with the Office of the CIO. ISG also consults regularly with portfolio managers and investment officers across the Firm. This material may include estimates, outlooks, projections and other "forward-looking statements." Due to a variety of factors, actual events may differ significantly from those presented.

This material is presented solely for informational purposes and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation or solicitation to buy, sell or hold a security. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.** Please see important disclosures at the end of this document.

THE KSE VALUE GROUP—INVESTMENT PERFORMANCE DISCLOSURE STATEMENT FIRST QUARTER 2009

	Composite			Benchmark		Composite				
	Composite Total Return (Gross of Fees) %	Composite Equity-Only Return (Gross of Fees) <sup>1</sup> %	Composite Total Return (Net of Fees) %	S&P 500 Index %	S&P 500 / Citigroup Value Index %	No. of Accounts	Market Value (millions)	Group Composite AUM (millions)	Total Firm Assets (billions)	Assets-Weighted Standard Deviation
YTD Jun 2009	N/A	(2.49)	(1.67)	(3.16)	(0.42)	581	635.3	1,390.2	N/A	N/A
2008	N/A	(29.18)	(20.15)	(37.00)	(39.22)	615	649.4	1,360.5	79.2	6.5
2007	N/A	15.85	12.39	5.49	1.99	675	870.0	1,706.1	148.5	4.7
2006	N/A	21.98	17.45	15.79	19.62	569	706.0	1,389.5	127.0	2.4
2005	3.48	3.99	2.44	4.91	6.33	410	474.5	981.4	105.9	2.3
2004	21.58	27.77	20.36	10.88	15.71	261	320.5	759.7	82.9	4.4
2003	15.88	20.32	14.75	28.68	31.79	318	403.0	820.6	70.5	4.1
2002	(9.66)	(16.25)	(10.63)	(22.10)	(20.85)	296	293.4	466.3	56.1	3.8
2001	2.25	2.30	1.00	(11.88)	(11.71)	110	94.3	160.2	59.0	2.9
2000	33.79	43.00	32.06	(9.11)	6.08	49	30.8	101.6	55.5	8.2
1999	4.53	4.75	3.54	21.04	12.72	55	38.1	101.5	54.4	7.5

<sup>1</sup> Not part of required presentation. Included as supplemental information only.

**The KSE Value Group (Inception 12/31/88)**

**1. Basis of Presentation:**

- Neuberger Berman LLC (“Neuberger” or “NB”), founded in 1939, is a Registered Investment Adviser and Broker-Dealer. As of May 4, 2009, the firm is an indirect, wholly owned subsidiary of Neuberger Berman Group LLC. From October 31, 2003, until May 4, 2009, the firm was called Neuberger Berman, LLC, and was a wholly owned subsidiary of Lehman Brothers Holdings Inc.
- Neuberger Berman LLC has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).
- The KSE Group’s Core Value Strategy (the “Composite”) is a diversified strategy intended for investors who wish to seek capital appreciation through participation in a mix of small-, mid- and large-capitalization equity investments. The strategy seeks companies with attractive risk/reward characteristics and positive catalysts that will help unlock value over time. Portfolios in this strategy are managed to exceed the return of the S&P 500 Index over time.
- The KSE Value Composite performance schedule is provided as supplemental information to the Firm composite.
- A complete list and description of Neuberger Berman’s composites and performance results is available upon request.

**2. Selection Criteria and Valuation Procedures:**

- The Composite includes all fee-paying, discretionary portfolios, which have a substantial allocation to equities, and a market value equal to or greater than \$250,000.
- The January 1989-through-present, all fee-paying, discretionary accounts managed by Michelle B. Stein are included in the Composite. For the period January 2002 to December 2003, the Composite includes all fee-paying, discretionary equity accounts managed by another Neuberger Portfolio Manager. From January 2003 to present, all fee-paying, discretionary equity accounts managed by Michael Emmerman are included in the Composite. From June 2006 to present, all fee-paying, discretionary equity accounts managed by Kenneth Kahn are also included in the Composite.
- Eligible new portfolios are added to the Composite at the beginning of the month following the first month the portfolio is managed. Portfolios are excluded as of the last full calendar month under management or such prior date Neuberger Berman LLC receives notice of termination and begins managing the portfolio in a manner different from other accounts in the Composite.
- Calculation methods and valuation sources are available upon request.

**3. Calculation of Rates of Return:**

- For each portfolio within the Composite, the total rate of return for the time period is equal to the change in value of the portfolio, including capital appreciation, depreciation and income, as a percentage of the beginning market value of the portfolio adjusted for the net of all contributions and withdrawals (the “cash flows”). All cash flows are weighted from the actual date of contribution or withdrawal in the month they occurred in order to minimize the effect of cash flows on the investment performance of the portfolio. Equity-only performance represents the total return of the segment of the manager’s portfolio allocated to equity securities. It excludes the performance of the cash and/or fixed income instruments that may also be held in the portfolio. All returns are stated in U.S. Dollar terms.
- The portfolio managers of the KSE Group may make both collective and independent investment decisions for client portfolios. As a result, portfolios will experience greater dispersion than they otherwise would, had all investment decisions been made collectively. Dispersion can also be impacted by factors including, but not limited

to, individual client investment objectives and guidelines, tax considerations, firm and regulatory trading restrictions, allocation of investment opportunities, order of execution, and method and timing of funding. Past performance is not indicative of future results.

- Effective January 1, 2006, accounts in the Composite were moved to an all-inclusive fee schedule. As such, all net returns are presented after deduction of all applicable fees, which include investment advisory fees, trading expenses, custody, and other administrative fees. The annual investment advisory fee, payable quarterly, for each portfolio with a market value of less than \$10mn is: 1.5% of the first \$2.5mn of market value; 1.4% of the next \$2.5mn of market value; 1.3% of the next \$2.5mn of market value; 1.2% of the next \$2.49mn. For each portfolio with a market value equal to, or greater than, \$10mn, the annual fee payable quarterly is: 1.25% of the first \$10mn of market value and 0.9% of the remaining value of market value.

**4. Composite Benchmarks:**

- Composite returns are shown in comparison to benchmark returns. The benchmark is used for comparative purposes only and generally reflects the risk or investment style of the investments reported on the schedule of investment performance.
- These benchmarks are unmanaged indices. Neuberger Berman LLC makes investments for the portfolios it manages according to the Client guidelines and may differ from those of the benchmarks.
- **Please see additional disclosures for complete benchmark descriptions.**

**PRIVATE ASSET MANAGEMENT EQUITY COMPOSITE—INVESTMENT PERFORMANCE DISCLOSURE STATEMENT  
FIRST QUARTER 2009**

	Composite <sup>2</sup>			Benchmark	Composite			
	Composite Total Return (Gross of Fees) %	Composite Equity-Only Return (Gross of Fees) <sup>1</sup> %	Composite Total Return (Net of Fees) %	S&P 500 Index %	No. of Accounts	Market Value (millions)	Total Firm Assets (billions)	Asset-Weighted Standard Deviation
YTD Jun 2009	N/A	8.19	6.13	3.16	8,718	15,801.6	N/A	N/A
2008	N/A	(45.18)	(40.49)	(37.00)	9,636	16,854.7	79.2	8.8
2007	N/A	12.41	10.87	5.49	12,874	36,843.9	148.5	6.8
2006	N/A	14.27	12.57	15.79	11,697	32,303.3	127.0	5.2
2005	15.09	15.74	14.11	4.91	9,998	26,367.5	105.9	9.5
2004	21.30	22.27	20.18	10.88	7,714	17,631.0	82.9	11.0
2003	30.30	33.40	29.12	28.68	6,762	13,477.2	70.5	10.1
2002	(18.59)	(20.87)	(19.37)	(22.10)	6,584	10,850.7	56.1	5.6
2001	(2.10)	(2.57)	(3.02)	(11.88)	7,153	13,979.8	59.0	10.8
2000	2.44	2.23	1.45	(9.11)	6,541	12,846.2	55.5	13.6
1999	18.27	19.35	17.21	21.04	5,870	12,400.9	54.4	15.6

<sup>1</sup> Not part of required presentation. Included as supplemental information only.

<sup>2</sup> Performance prior to 1997 is not covered by Attestation Report of Independent Accountants.

**Equity Composite—(Inception 12/31/89)**

**1. Basis of Presentation:**

- Neuberger Berman LLC (“Neuberger” or “NB”), founded in 1939, is a Registered Investment Adviser and Broker-Dealer. As of May 4, 2009, the firm is an indirect, wholly owned subsidiary of Neuberger Berman Group LLC. From October 31, 2003, until May 4, 2009, the firm was called Neuberger Berman, LLC, and was a wholly owned subsidiary of Lehman Brothers Holdings Inc.
- Neuberger Berman LLC has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®) for the period January 1, 1990, through present.
- The Private Asset Management (“PAM”) Equity Composite (the “Composite”) represents all fee-paying, discretionary equity accounts managed by portfolio managers in the Private Asset Management group of Neuberger Berman. The composite consists of equity-oriented portfolios that seek to provide superior returns through broad equity market participation. The portfolios are diversified across industries and are invested primarily in U.S. equities, with the goal of long-term capital appreciation.
- A complete list and description of Neuberger Berman’s composites and performance results is available upon request.

**2. Selection Criteria and Valuation Procedures:**

- The PAM Equity Composite includes all fee-paying portfolios with a market value equal to or greater than \$250,000 managed on a fully discretionary basis by Neuberger Berman according to the PAM Equity Composite strategy. The composite was created on January 1, 1999.
- Eligible new portfolios are added to the Composite at the beginning of the month following the first month the portfolio is managed. Portfolios are excluded as of the last full calendar month under management or such prior date Neuberger Berman LLC receives notice of termination and begins managing the portfolio in a manner different from other accounts in the Composite.
- Calculation methods and valuation sources are available upon request.

**3. Calculation of Rates of Return:**

- For each portfolio within the Composite, the total rate of return for the time period is equal to the change in value of the portfolio, including capital appreciation, depreciation and income, as a percentage of the beginning market value of the portfolio adjusted for the net of all contributions and withdrawals (the “cash flows”). All cash flows are weighted from the actual date of contribution or withdrawal in the month they occurred in order to minimize the effect of cash flows on the investment performance of the portfolio. Equity-only performance represents the total return of the segment of the manager’s portfolio allocated to equity securities. It excludes the performance of the cash and/or fixed income instruments that may also be held in the portfolio. All returns are stated in U.S. Dollar terms.
- Effective January 1, 2006, accounts in the Composite were moved to an all-inclusive fee schedule. As such, all net returns are presented after deduction of all applicable fees, which include investment advisory fees, trading expenses, custody, and other administrative fees. The annual investment advisory fee, payable quarterly, for each portfolio with a market value of less than \$10mn is: 1.5% of the first \$2.5mn of market value; 1.4% of the next \$2.5mn of market value; 1.3% of the next \$2.5mn of market value; 1.2% of the next \$2.49mn. For each portfolio with a market value equal to, or greater than, \$10mn, the annual fee payable quarterly is: 1.25% of the first \$10mn of market value and 0.9% of the remaining value of market value.

**4. Composite Benchmarks:**

- Composite returns are shown in comparison to benchmark returns. The benchmark is used for comparative purposes only and generally reflects the risk or investment style of the investments reported on the schedule of investment performance.
- These benchmarks are unmanaged indices. Neuberger Berman LLC investments for the portfolios it manages according to the PAM Equity Composite strategy may differ from those of the benchmarks.
- The benchmark returns are not covered by the Independent Accountant’s Report.
- **Please see additional disclosures for complete benchmark descriptions.**

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