

Small/Mid Cap Topics

To Q4 and Beyond!

■ Equities

- **Q3 and September Recap** — Small cap outperformed during September, yet lagged for Q3. Materials and Energy stood out for the month and quarter, with Staples and Tech lagging. Value gained on Growth for both periods. Higher beta, Q2 laggards, lower valuations, and higher leverage were outperforming factors.
- **Q4 Outlook** — Continued consolidation is expected near term, as the SMID market digests Q3 earnings and related Q4 guidance, followed by seasonal strength into year-end as we gain more clarity around election and fiscal cliff issues. This should provide an economic sensitive sector edge. We maintain our RUT 875 and RMC 1180 year end targets.
- **Preliminary 2013 Index Targets** — We are introducing preliminary 2013 index targets of 910 for the Russell 2000 and 1250 for the Russell Mid Cap representing upside of 8.3% and 13.8%, respectively. This base case compares with upside of 12.1% to Citi US Equity Strategist Tobias Levkovich's year-end 2013 S&P 500 target of 1615.
- **2013 Perspectives** — Bottom up EPS (ex-neg) growth for the Russell 2000 is projected at 19%, and for the RMC at 12%. Small cap expectations, in particular, continue to look aggressive relative to the 2% or so GDP growth which Citi economists are projecting. As such, our base case is for earnings growth to approximate 10% or so, implying little change to valuation metrics.
- **The Bull Case for Small Cap?** — We are frequently asked what the bull case for small cap is. Our preliminary thoughts are that renewed confidence in rising economic growth is a necessary precursor to triggering reacceleration in earnings growth (without enduring a recessionary phase first), and valuations in turn. This would most likely result from a refocus in fiscal policy, which remains difficult to project.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Q3 and September Performance Recap

All of the major indices posted solid gains for the month of September, as well as for Q3.

All of the major indices posted solid gains for the month of September, as well as for Q3. Large cap had the strongest Q3 performance, followed by mid, then small. Within the small/mid cap indices, Value had a slight performance edge over Growth for the quarter, further narrowing Growth's YTD outperformance. Materials and Energy were among the top performing sectors for the quarter, along with Consumer Discretionary and mid cap Health Care. Consumer Staples and Information Technology were among the laggards.

For the month of September, small cap was the best performing asset class, followed by large, then mid. Value outperformed for the month, contributing to its Q3 outperformance. Similar to the Q3 trend, Materials and Energy were among the top sector performers, with Health Care also posting solid returns. Also similar to Q3 results, Consumer Staples and Information Technology both underperformed for the month.

Figure 1. September, Q3, and YTD Index Performance

Russell 2000 Core				Russell 2000 Growth			Russell 2000 Value		
Sector	Sep	Q3	YTD	Sep	Q3	YTD	Sep	Q3	YTD
Index	3.12%	4.88%	13.03%	2.94%	4.65%	13.45%	3.30%	5.11%	12.59%
Consumer Discretionary	3.19%	7.11%	19.41%	2.05%	6.34%	18.84%	4.78%	8.19%	20.26%
Consumer Staples	2.36%	1.94%	11.05%	1.71%	1.72%	11.07%	3.54%	2.33%	11.22%
Energy	5.35%	7.39%	-3.09%	5.29%	8.49%	-5.27%	5.39%	6.46%	0.71%
Financials	2.44%	4.67%	15.50%	1.39%	4.40%	12.53%	2.64%	4.72%	16.12%
Health Care	4.56%	4.64%	26.34%	4.50%	3.81%	27.16%	4.83%	8.42%	23.33%
Industrials	3.05%	3.26%	7.37%	2.55%	2.82%	6.23%	3.70%	3.83%	8.74%
Information Technology	1.25%	2.36%	7.51%	1.74%	3.99%	10.91%	0.39%	-0.38%	1.34%
Materials	6.28%	12.58%	16.66%	5.54%	10.02%	16.16%	6.89%	14.71%	16.96%
Telecommunication Services	8.95%	13.74%	20.58%	9.55%	15.88%	25.04%	8.17%	10.96%	14.47%
Utilities	2.72%	4.89%	4.32%	5.07%	5.50%	-1.51%	2.61%	4.86%	4.41%

Russell Mid Cap Core				Russell Mid Cap Growth			Russell Mid Cap Value		
Sector	Sep	Q3	YTD	Sep	Q3	YTD	Sep	Q3	YTD
Index	1.94%	5.14%	12.55%	1.89%	5.06%	12.98%	1.97%	5.21%	12.06%
Consumer Discretionary	1.84%	7.68%	17.19%	1.51%	7.03%	15.85%	2.67%	9.28%	21.43%
Consumer Staples	0.67%	-0.99%	6.72%	-0.68%	-3.48%	4.95%	2.67%	2.83%	10.94%
Energy	3.58%	11.36%	3.30%	4.27%	13.14%	2.39%	3.22%	10.43%	4.91%
Financials	1.18%	3.58%	14.57%	0.93%	3.22%	13.69%	1.24%	3.66%	14.76%
Health Care	5.50%	6.59%	24.44%	5.80%	6.83%	29.01%	5.00%	6.08%	14.87%
Industrials	2.13%	4.82%	9.72%	1.60%	2.95%	7.88%	2.76%	7.18%	11.99%
Information Technology	-0.99%	3.08%	9.48%	-0.19%	3.86%	11.57%	-2.20%	1.90%	5.56%
Materials	3.96%	6.59%	14.24%	3.62%	8.01%	18.89%	4.27%	5.33%	7.43%
Telecommunication Services	6.52%	21.64%	25.94%	2.60%	7.81%	20.25%	10.99%	40.61%	24.07%
Utilities	1.35%	0.78%	3.70%	7.00%	11.54%	1.22%	1.01%	0.16%	3.38%

S&P 500			
Sector	Sep	Q3	YTD
Index	2.42%	5.76%	14.56%
Consumer Discretionary	3.10%	7.07%	19.99%
Consumer Staples	1.11%	3.08%	10.26%
Energy	3.31%	9.52%	5.83%
Financials	3.28%	6.43%	19.88%
Health Care	3.81%	5.56%	15.77%
Industrials	1.53%	2.98%	9.23%
Information Technology	1.18%	7.04%	20.64%
Materials	3.55%	4.46%	10.00%
Telecommunication Services	3.85%	6.79%	21.04%
Utilities	0.89%	-1.55%	1.05%

Source: Russell, S&P, FactSet

From a factor standpoint, the following factors outperformed in Q3, implying a reversal of the "quality trade" that proved successful through earlier parts of the year.

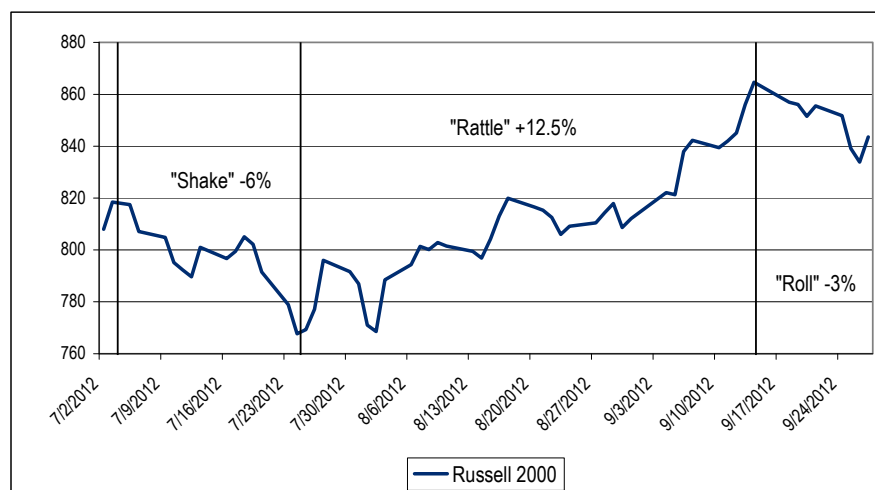
- Higher beta stocks

- June and Q2 laggards
- Lower valuations
- More highly levered companies

While, on the surface, small and mid cap Q3 returns suggest pretty solid one quarter performance, the “intra-quarter” action was quite volatile, with an early in the quarter “shake”, a mid quarter “rattle”, and an end of the quarter “roll”.

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Figure 2. Russell 2000 Q3 Performance Phases



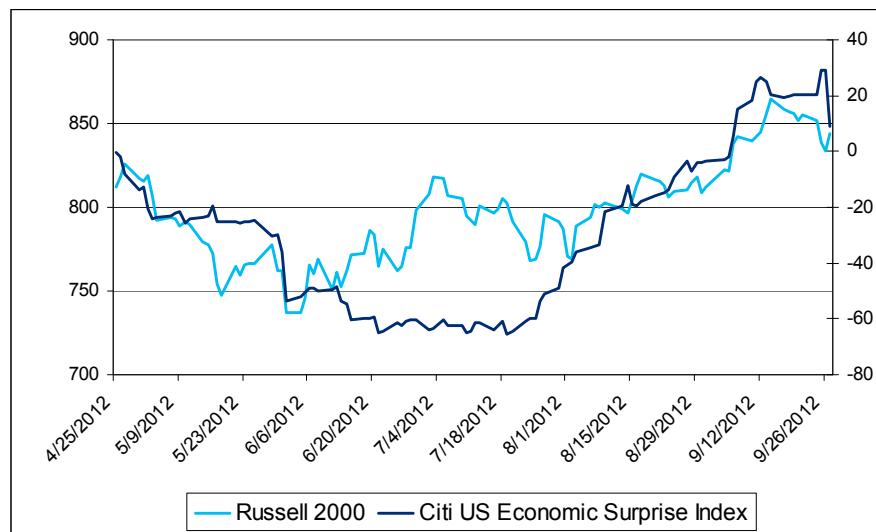
Source: Bloomberg, Citi Research

Our sense is that SMID investors entered Q3 with mixed positioning, but with a defensive/quality bias.

Generally, our sense is that SMID investors entered Q3 with mixed positioning, but with a defensive/quality bias. This positioning was most likely influenced by the sharp April-May sell off. In turn, it was reinforced by the early July weakness. However, the “rattle” phase during the quarter reflected characteristics of an economic sensitive rotation, which coincided with a positive inflection in Citi’s Economic Surprise index. At the same time, investor anticipation of a Fed quantitative easing announcement at its mid-September meeting served as a further catalyst. Yet, as we argued in our [This Time Is Different](#) Rap note from Sept 14, with the RUT rallying into the Fed announcement, it hit a classic overbought condition immediately following the move. From that point, the SMID indices have consolidated as economic data has been mixed, and while Q3 and Q4 earnings concerns have been increasing.

A quick analysis of small cap growth and value mutual fund performance indicates that, despite decent Q3 performance (63% of growth managers and 47% of value managers outperformed respective Russell 2000 indices), the majority of small cap growth and value managers are having a tough time keeping up with those Russell benchmarks year-to-date. Our small cap mutual fund analysis shows 46% of growth funds and 42% of value funds are performing ahead of those Russell benchmarks.

Figure 3. Russell 2000 vs. Citi US Economic Surprise Index

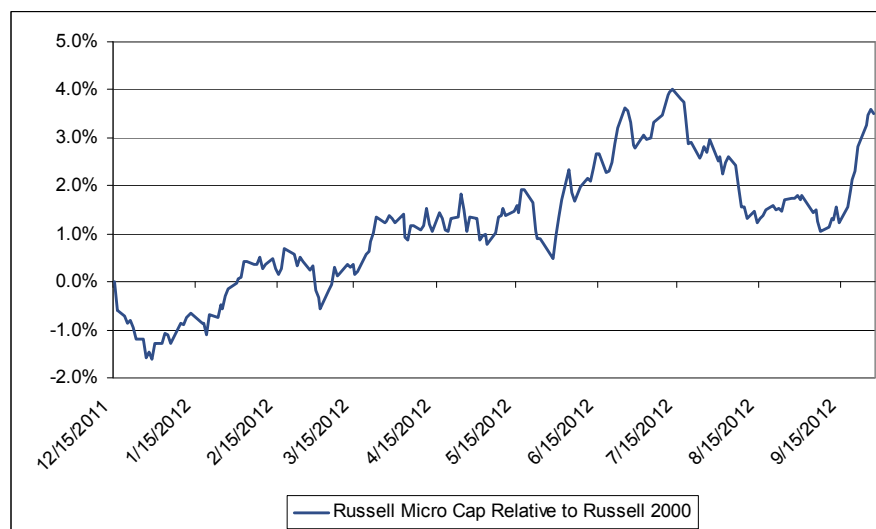


Source: Bloomberg

Finally, as to “size” implications within small cap, there was not much discernible impact for the quarter. But, “micro cap” continues to lead YTD performance. Interestingly, the larger end of small cap gained a performance edge through most of Q3. Yet, micro cap staged a solid relative performance rally during the final two weeks of the quarter. Our speculation is that post Fed announcement profit taking may have focused on more liquid names, which is indicative of the underlying light trading volumes which characterized the quarter.

“Micro cap” continues to lead YTD performance. Our speculation is that post Fed announcement profit taking may have focused on more liquid names.

Figure 4. Russell Micro Cap Relative to Russell 2000



Source: Bloomberg

Preliminary 2013 Index Targets

We are introducing preliminary 2013 index targets of 910 for the Russell 2000 and 1250 for the Russell Mid Cap.

We are introducing preliminary 2013 index targets of 910 for the Russell 2000 and 1250 for the Russell Mid Cap representing upside of 8.3% and 13.8%, respectively*. This establishes a “base case” for the out year and compares with upside of 11.8% to Citi US Equity Strategist Tobias Levkovich’s year-end 2013 S&P 500 target of 1615 (see [Setting the Scene for Twenty Thirteen](#)). Given mid cap’s YTD underperformance, we think it is reasonable to expect some degree of mean reversion in the coming year. However, without a shift in investor focus away from income and quality, which cause a bias toward larger caps, we find it difficult to make a case for small cap outperformance in 2013.

Figure 5. Russell 2000 2013 Target

Model	2013 Russell 2000 Target	
	12m Avg Fwd Rtn	12m Med Fwd Rtn
Comparable P/E periods (23.5-25.5x)	4.6%	4.1%
Implied Level	895	891
Comparable P/B periods (1.75-2.05x)	3.8%	5.8%
Implied Level	888	905
Comparable P/S periods (1.1-1.25x)	6.7%	11.5%
Implied Level	913	954
Comparable div yld periods (1.25-1.45%)	0.0%	0.0%
Implied Level	856	856
Comparable Fwd P/E periods (14-16x)	11.2%	14.0%
Implied Level	952	975

Source: Russell, FactSet, Citi Research

Figure 6. Russell Mid Cap 2013 Target

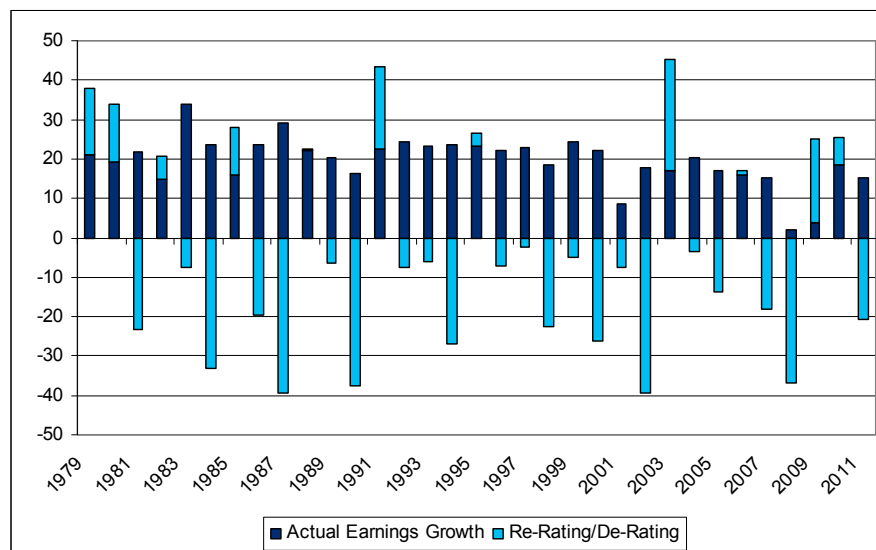
Model	2013 Russell Mid Cap Target	
	12m Avg Fwd Rtn	12m Med Fwd Rtn
Comparable P/E periods (17-20x)	8.1%	13.6%
Implied Level	1,208	1,268
Comparable P/B periods (1.75-2.2x)	12.3%	13.4%
Implied Level	1,254	1,267
Comparable P/S periods (1.1-1.35x)	9.8%	15.6%
Implied Level	1,227	1,292
Comparable div yld periods (1.45-1.75%)	11.9%	15.4%
Implied Level	1,250	1,289
Comparable Fwd P/E periods (12-15x)	11.7%	15.9%
Implied Level	1,248	1,295

Source: Russell, FactSet, Citi Research

We derive our targets by assessing and averaging historical returns across several valuation metrics. Additionally, we note that opportunities to “re-rate” (i.e. multiple expansion) are the exception over the past 30 years. In fact, most “re-rating” has occurred during or immediately following recessionary periods. For most other time frames, P/E multiples have not kept pace with earnings. On the presumption that current bottom up ex-negative earnings growth of high teens for the RUT and low teens for the RMC prove optimistic and trend lower through the year, our price targets should prove directionally appropriate.

Opportunities to “re-rate” (i.e. multiple expansion) are the exception over the past 30 years.

Figure 7. Russell 2000 Historical Return Decomposition



Source: Russell, FactSet, Citi Research

* Targets based on Sep 21 index levels and historical average returns from current valuation levels.

Q4 and 2013 Perspectives

We expect some continued consolidation near term, followed by seasonal strength into year-end.

Looking forward to Q4 and 2013, we expect some continued consolidation near term as euphoria from the Fed's QE3 announcement wears off and markets digest Q3 earnings, followed by seasonal strength into year-end as we gain more clarity around election and fiscal cliff issues. Even if outcomes are not as pro-business as many investors might hope, the alleviation of uncertainty should improve investors' conviction in positioning and help some money come "off the sidelines". We maintain our year-end 2012 index targets of 875 and 1180, implying respective upside of 4.1% for the RUT and 7.4% for the RMC.

However, as discussed in more detail in the "Signs Along the Road" section below, estimates have been falling throughout the year, and may continue to do so. 2012 earnings growth projections are heavily dependent on Q4 estimates meeting expectations. Given the political and macroeconomic uncertainty permeating executive suites, we suspect that estimates may be difficult to achieve, and expect further resetting of earnings expectations as a result.

Figure 8. Russell 2000 2012 Quarterly EPS Growth

	Russell 2000 (Current Constituents)			
	Q1	Q2	Q3	Q4
EPS (ex-neg) 2011	10.46	11.68	12.10	11.91
EPS (ex-neg) 2012	10.92	12.12	11.95	12.65
Growth	4%	4%	-1%	6%

Source: FactSet

Figure 9. Russell Mid Cap 2012 Quarterly EPS Growth

	Russell Mid Cap (Current Constituents)			
	Q1	Q2	Q3	Q4
EPS (ex-neg) 2011	15.37	17.14	17.76	16.68
EPS (ex-neg) 2012	16.41	18.47	17.65	17.93
Growth	7%	8%	-1%	8%

Source: FactSet

Turning to next year, The Russell 2000 is projected to grow EPS (ex-neg) by 19% in 2013. Traditionally cyclical sectors are projected to contribute most of that growth, with Industrials, Tech, and Consumer Discretionary all comprising 15% or more of expected growth, and Financials also a significant contributor.

Figure 10. Russell 2000 Sector EPS (ex-neg) Growth Contributions

Sector	Weight	EPS 2012	EPS 2013	Growth	Average Growth	Median Growth	Ctrb	Ctrb %	Ctrb % - Wgt
Consumer Discretionary	14%	7.04	8.33	18%	43%	17%	3%	15%	1%
Consumer Staples	4%	1.63	1.87	15%	20%	14%	1%	3%	-1%
Energy	6%	2.82	3.80	35%	116%	29%	2%	11%	5%
Financials	22%	11.24	12.56	12%	54%	11%	3%	15%	-7%
Health Care	13%	3.55	4.28	21%	67%	17%	2%	8%	-5%
Industrials	15%	8.48	10.15	20%	54%	19%	4%	19%	4%
Information Technology	17%	7.08	8.67	23%	58%	22%	3%	18%	1%
Materials	5%	2.49	3.32	33%	96%	25%	2%	9%	4%
Telecommunication Services	1%	0.26	0.29	13%	12%	14%	0%	0%	0%
Utilities	4%	1.66	1.81	8%	10%	9%	0%	2%	-2%
Russell 2000		46.24	55.08	19%	57%	17%			

Source: FactSet

The Russell Mid Cap is projected to grow EPS (ex-neg) by 12% in 2013. Once again, Industrials, Tech, and Consumer Discretionary are projected to contribute significant amounts of that earnings growth, along with Materials and Financials.

Figure 11. Russell Mid Cap Sector EPS (ex-neg) Growth Contributions

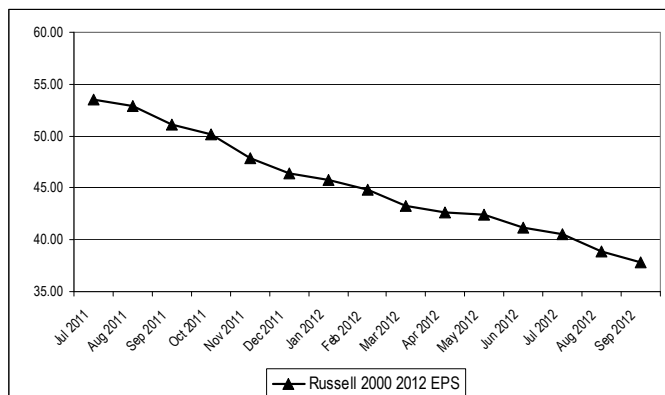
Sector	Weight	EPS 2012	EPS 2013	Growth	Average Growth	Median Growth	Ctrb	Ctrb %	Ctrb % - Wgt
Consumer Discretionary	17%	11.76	12.83	9%	67%	15%	2%	12%	-4%
Consumer Staples	6%	4.33	4.75	10%	11%	10%	1%	5%	-1%
Energy	7%	5.41	6.22	15%	27%	24%	1%	9%	2%
Financials	20%	12.95	14.21	10%	15%	10%	2%	15%	-5%
Health Care	10%	6.68	7.51	12%	15%	11%	1%	10%	0%
Industrials	13%	9.87	11.44	16%	17%	14%	2%	18%	6%
Information Technology	14%	9.78	11.10	13%	34%	13%	2%	15%	1%
Materials	6%	4.63	5.74	24%	30%	19%	2%	13%	7%
Telecommunication Services	2%	0.34	0.39	15%	10%	4%	0%	1%	-1%
Utilities	6%	4.03	4.26	6%	12%	6%	0%	3%	-3%
Russell Mid Cap		69.78	78.45	12%	28%	13%			

Source: FactSet

2013 Signs Along the Road

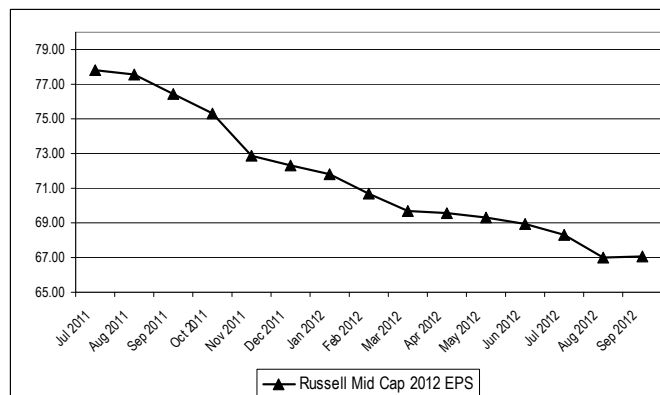
2012 bottom-up EPS estimates for the Russell 2000 and Mid Cap have been in decline throughout the course of the year. Although they showed some preliminary signs of bottoming at several points, these proved to be “head fakes”, as earnings estimate cuts continued.

Figure 12. Russell 2000 2012 EPS Estimate History



Source: FactSet

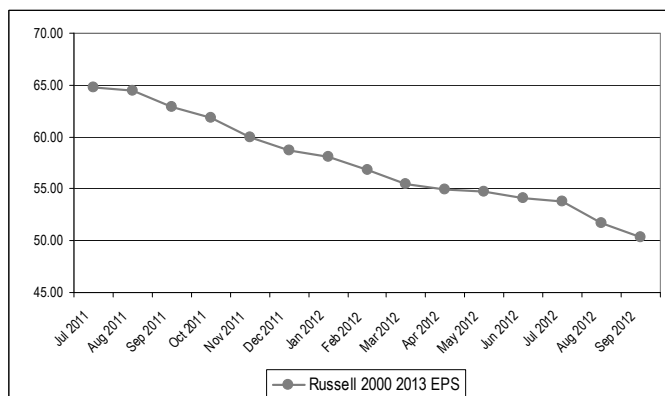
Figure 13. Russell Mid Cap 2012 EPS Estimate History



Source: FactSet

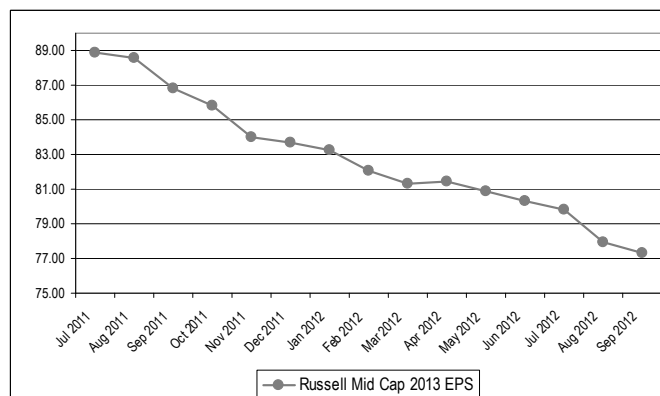
2013 bottom-up estimates have also been falling throughout the year for both small and mid caps. Similar to the 2012 estimates, they gave several preliminary signs of bottoming, but those signs proved to be premature as estimates continued to fall through Q3.

Figure 14. Russell 2000 2013 EPS Estimate History



Source: FactSet

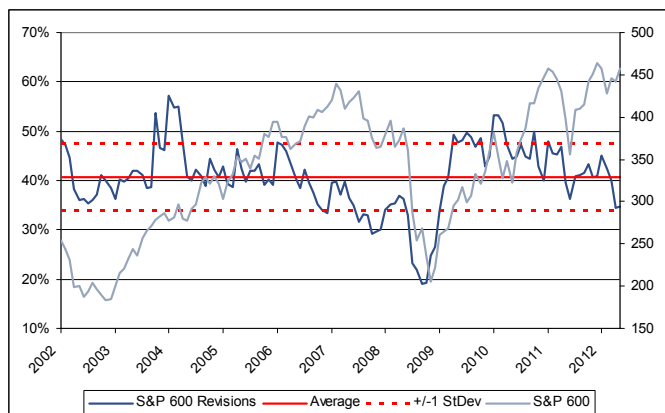
Figure 15. Russell Mid Cap 2013 EPS Estimate History



Source: FactSet

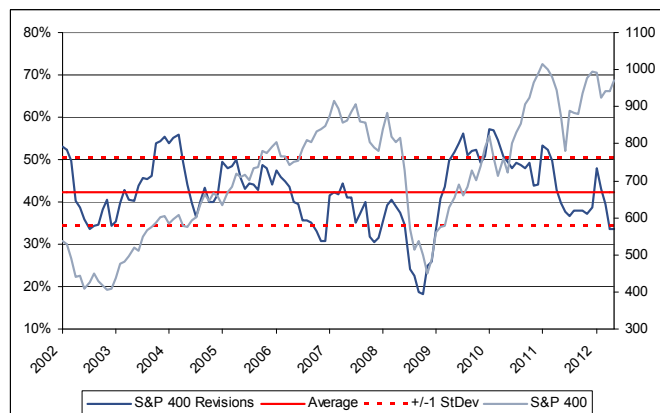
Revision trends have also recently fallen to near -1 standard deviation levels for both small and mid after a wave of positive revisions helped to lift this metric earlier in the year. Although we see ongoing risk to estimates, the revision data provides some encouragement that the negative revision process is well underway, and is anticipated by most investors.

Figure 16. S&P 600 % Positive Earnings Revisions



Source: FactSet

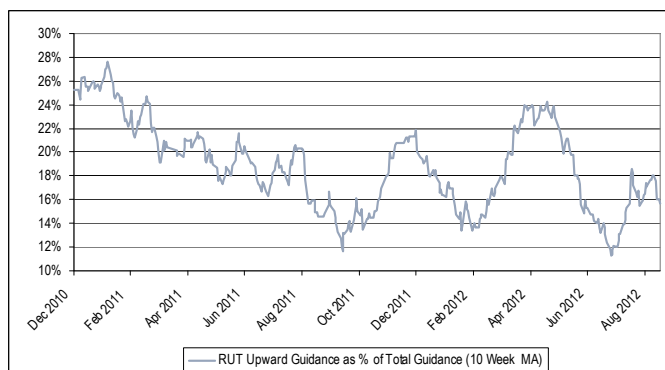
Figure 17. S&P 400 % Positive Earnings Revisions



Source: FactSet

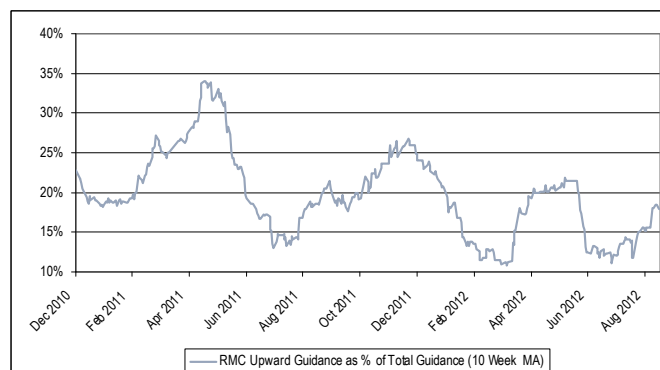
On the other hand, company guidance has been on an upswing in recent months. Levels are currently about half way between previous cycle peaks and troughs. Of course, this data is not intuitively obvious, and we expect a negative bias to Q4 guidance in particular as we move through the Q3 reporting period.

Figure 18. Russell 2000 % Positive Guidance



Source: Bloomberg

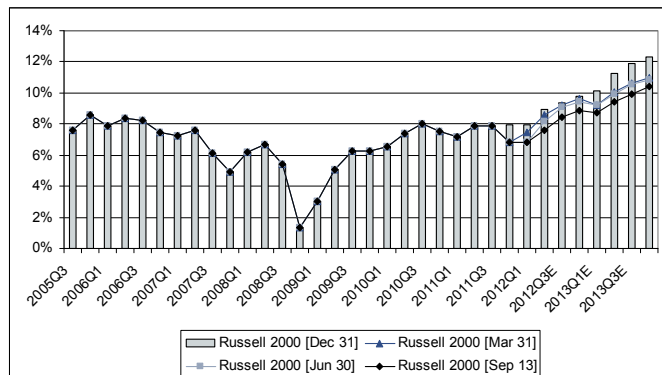
Figure 19. Russell Mid Cap % Positive Guidance



Source: Bloomberg

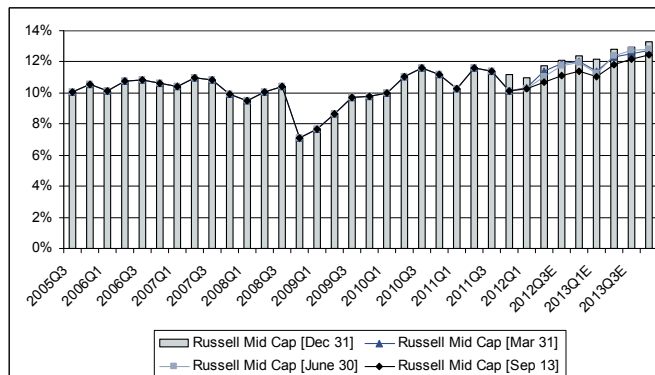
Bottom up EBIT margin projections have fallen over the past several quarters, but margins are still forecasted to expand through 2013. Projections for recovery high margins do present some reason for concern, particularly as margin expansion projected a year ago at this time (as we headed into 2012) has failed to meet earlier expectations. In turn, given the YTD double digit index level gains, it would seem that margin expectations have had more of an effect on the small/mid cap valuation opportunity, but in the context of solid full year returns. Leaner post-recession business models have no doubt contributed to margin recovery. But, we suspect that the pressure will be on sales growth trends to support current margin expectations. A 2% GDP backdrop should provide a headwind to attaining projected margins.

Figure 20. Russell 2000 Margin Projections



Source: FactSet

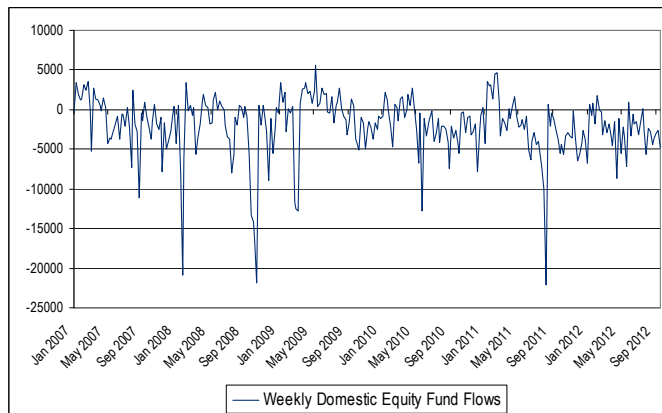
Figure 21. Russell Mid Cap Margin Projections



Source: FactSet

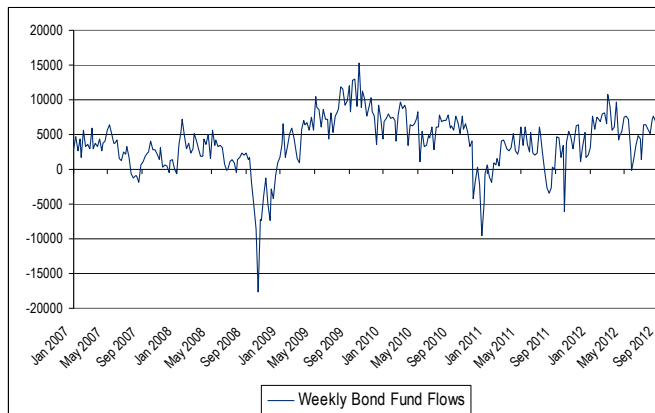
Furthermore, we think that flows out of bonds and into stocks could represent an important catalyst for markets to work higher. The dynamic has continued in the opposite direction recently, although low bond yields and strong equity performance could shift the pendulum in the opposite direction.

Figure 22. Weekly Domestic Equity Fund Flows



Source: ICI/Haver Analytics

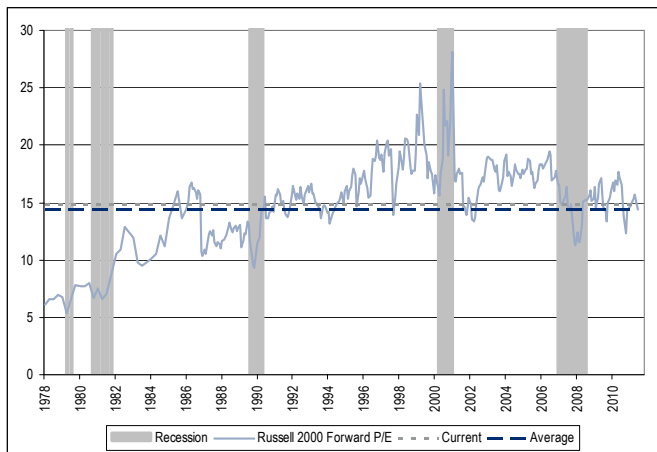
Figure 23. Weekly Bond Fund Flows



Source: ICI/Haver Analytics

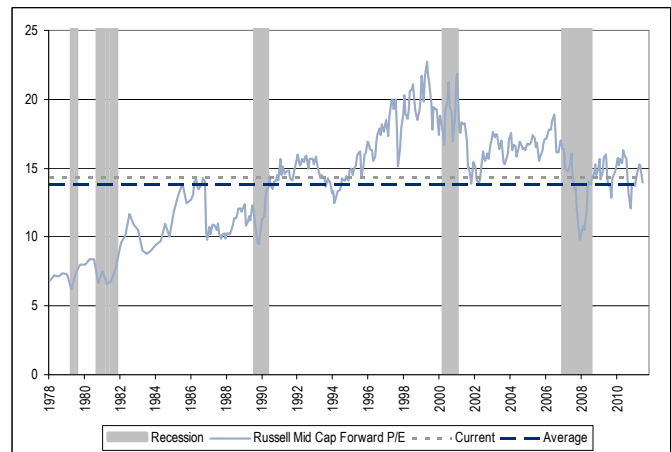
Small and mid cap valuations remain fairly neutral. Forward earnings multiples sit slightly above historical averages, but still at the lower end of their historical ranges. Trailing P/E's look somewhat stretched, but valuations are still attractive on book value and cash flow. However, we recognize the possibility for stretched valuations should markets continue to work higher without a corresponding increase in earnings expectations.

Figure 24. Russell 2000 Forward P/E



Source: Russell, FactSet, NBER

Figure 25. Russell Mid Cap Forward P/E



Source: Russell, FactSet, NBER

The “Bull Case for Small Cap”?

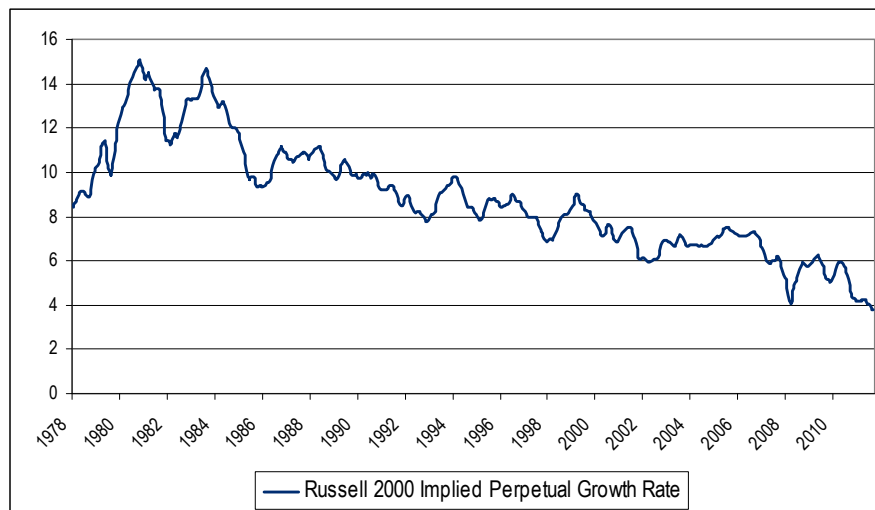
We are frequently asked what the “bull case” for small cap is.

To this point, we are frequently asked what the “bull case” for small cap is, particularly against weak relative returns in 2011, and potentially 2012. We plan to write on this more between now and year end. But our preliminary thoughts stack up as follows:

- Small vs. large “relative” valuations present the most significant headwind to small cap out performance. This is further hampered by the current investor appetite for yield and “quality”, against a low interest rate and slow economic growth environment.
- On the other hand, small cap “absolute” valuations are near the lower end of the past twenty year channel. We believe this is indicative of a slow growth expectation, but may set the stage for a more structural bull move.
- In turn, the bull case for small cap rests on a change in sentiment toward a renewed confidence in economic growth expectations. In our [Driving Off the Map](#) 2012 outlook note, we made the case that the past 30 year history of small cap has been comprised of shorter recessions, followed by longer expansionary phases. With these expansionary phases has come outsized earnings growth for small cap relative to large cap. In turn, this tends to get built into small cap earnings expectations. A 2%-ish GDP backdrop does not provide a sufficient tailwind for growth expectations to be met. In such an environment, small cap becomes much more subject to “risk on/risk off” broader market proclivities.
- A combination of accelerating economic growth and current valuations should, therefore, be the precursor to any “bull case” for small cap. Intuitively, against such a backdrop, the “beta” advantage for small cap would kick in, further leveraging the asset class relative to any broader market move.
- In essence, the bull case rests on late cycle acceleration in macro growth without first having to endure a recessionary phase. This is certainly possible given the subpar recovery thus far, which has left the broader economy operating below potential. Additionally, renewed confidence in growth could cause a backup in interest rates which could, in turn, trigger fund flows out of bonds and into stocks.
- It would seem that the possibility for such a small cap bull move will have to emerge from a fiscal policy response that increases confidence in the growth outlook while also providing a game plan for addressing longer term US debt issues. This is no easy task!

In Figure 26, we show the “implied growth rate” for the Russell 2000, similar to Tobias Levkovich’s S&P 500 chart. The interpretation is the same for both indices: the investment community seems aware of earnings estimate challenges, making markets look attractively valued on this metric.

Figure 26. Russell 2000 Implied Perpetual Growth Rate



Source: Russell, FactSet, Citi Research

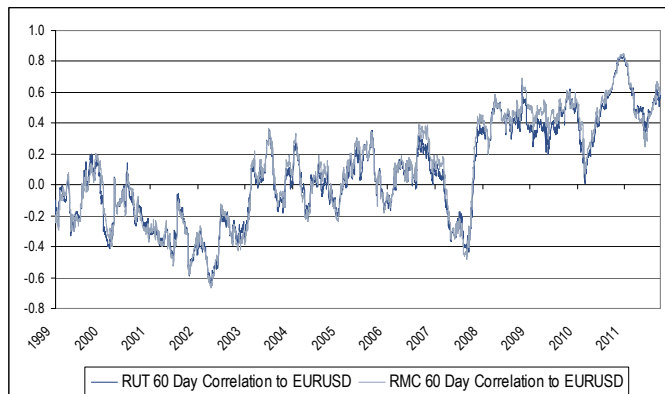
Watching for Potholes

Clearly, global political and macroeconomic factors present risks to our outlook. The US election and fiscal cliff, Chinese slowdown, and European sovereign crisis all represent risks that could materially impact our forecast.

We are beginning to get some more clarity on the US presidential election picture, and associated impact on stocks and industries. Citi Political Strategist Tina Fordham believes that an Obama victory is the most likely outcome, although she does not rule out the possibility of a game-changing “October surprise” (see [US Elections Outlook: It's Not Just The Economy, Stupid](#)).

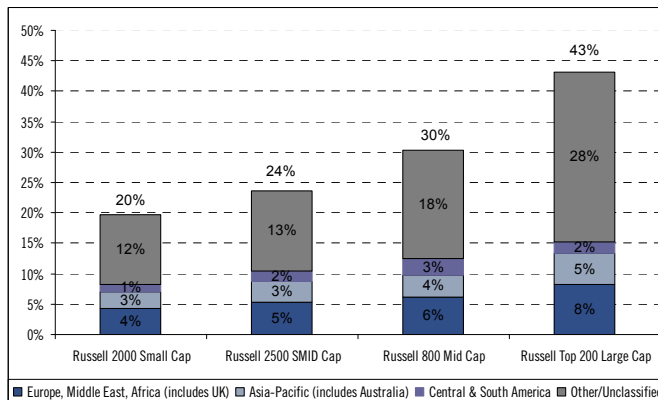
While it is difficult to predict an outcome in China, we do have some information on the European situation. Correlations between US stock returns and the EURUSD exchange rate are at the high end of historical experience, and a revenue exposure breakdown reveals that foreign exposure decreases as one moves down the market cap spectrum. In this regard, small cap takes on relative attractiveness for its insulation from the European drama.

Figure 27. Russell 2000 and Mid Cap Correlation to EURUSD



Source: Bloomberg

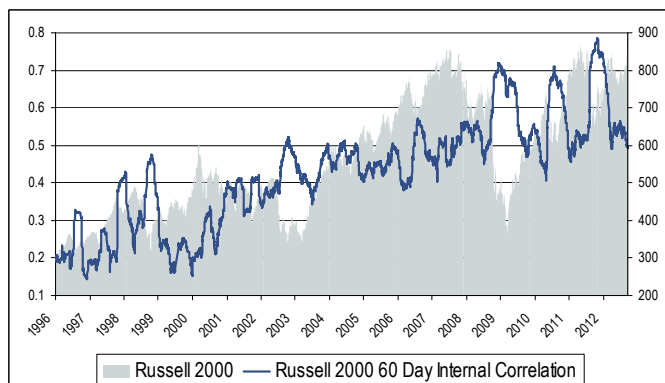
Figure 28. Russell Index International Exposure



Source: Bloomberg

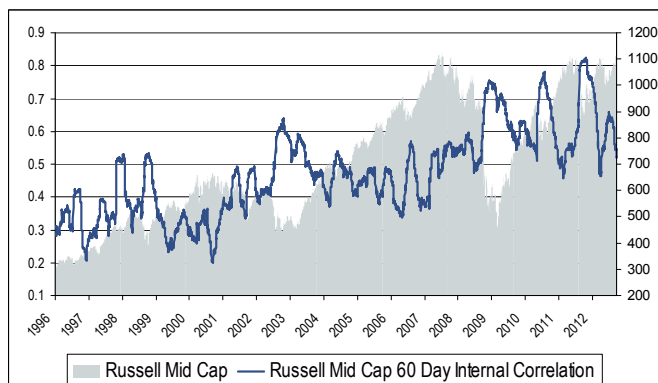
Correlations remain near the low end of recent experience. Our “SCOR Indicators” gave a negative signal when correlation bottomed in April, as correlation increases have tended to correspond to falling markets. However, correlations have remained low, suggesting an additional risk factor should they start to rise.

Figure 29. Russell 2000 Internal Correlation



Source: Bloomberg

Figure 30. Russell Mid Cap Internal Correlation



Source: Bloomberg

Stock Picks and Model Preferences

Our sector preferences reflect a clear pro-cyclical bias. We maintain Overweights in both Energy and Information Technology, with an offsetting Underweight in Financials.

Figure 31. Sector Weights

Overweight	Market Weight	Underweight
Energy	Consumer Discretionary	Financials
Information Technology	Consumer Staples	
	Health Care	
	Industrials	
	Materials	
	Telecommunication Services	
	Utilities	

Source: Citi Research

Our “Value Creators” focus list is shown below in Figure 32.

Figure 32. "Value Creators" List

YTD		<div>Recent Changes: *SLAB and CIEN were added and TER and FNSR were removed after the close on 9/6/2012. See call note for details. *SD was added after the close on 8/6/2012. See call note for details. *URI was added after the close on 7/30/2012. See call note for details. <i>List changes are announced via a call note posted on Velocity and other internal research systems;</i> <i>FA's with questions, please contact MSSB Equity Sales at 914-225-7000.</i></div>
Through September 30, 2012		
Russell 2500 Performance	13.58%	
Russell 2500 Total Return	15.02%	
Value Creators List Index Equal Weighted Performance	4.86%	
Value Creators List Index Equal Weighted Total Return	5.91%	

	Statistical Overview							Analyst Ratings, Targets & Estimates						Attributes		
	Date Added	Price Added	Price 9/30/2012	Perf. Since Added	Mkt. Cap (mil)	2012 Perf. YTD	Fiscal Year End	Rating	Price Target	EPS Estimates 2013	2012	2013	P/E 2012	5-Year Beta	Div. Yield	Investment Thesis
CONSUMER DISCRETIONARY																
Finish Line (FINL)	4/18/2011	\$20.89	\$22.73	8.81%	\$1,155.45	17.86%	Feb	1	\$30.00	\$1.95	\$1.71	11.7	13.3	1.26	0.9%	Sales and margin upside, product cycle, occupancy leverage, LBO characteristics
American Axle & Manufacturing Holdings (AXL)	12/19/2011	\$9.06	\$11.27	24.39%	\$843.44	13.95%	Dec	1	\$15.00	\$2.32	\$1.85	4.9	6.1	2.48	0.0%	Revenue growth/backlog, limited Europe exposure, strong margins
Steven Madden, Ltd. (SHOO)	12/19/2011	\$33.71	\$43.72	29.69%	\$2,002.99	26.72%	Dec	1	\$50.00	\$3.16	\$2.78	13.8	15.7	1.53	0.0%	Lead times, fashion execution, M&A track record, trade down, value pricing, footwear cycle
Iconix Brand Group Inc. (ICON)	4/16/2012	\$16.66	\$18.24	9.48%	\$1,244.22	11.97%	Dec	1	\$21.00	\$1.98	\$1.70	9.2	10.8	1.45	0.0%	Strong FCF generation used for repurchase and M&A, underappreciated int'l opportunity
ENERGY																
C&J Energy Services (CJES)	12/19/2011	\$19.84	\$19.90	0.30%	\$1,049.87	-4.92%	Dec	1	\$24.00	\$3.90	\$3.93	5.1	5.1	1.37	0.0%	US shale exposure, strong competitive position in fracking services
Atlas Pipeline Partners (APL)	2/27/2012	\$37.71	\$34.10	-9.57%	\$1,831.97	-8.21%	Dec	1	\$42.00	\$1.33	\$1.32	25.6	25.9	1.53	5.2%	Expansion opportunities supporting distribution growth, asset position, plant expansions
SandRidge Energy Inc (SD)	8/6/2012	\$6.66	\$6.98	4.73%	\$3,422.81	-14.52%	Dec	1	\$8.50	\$0.02	\$0.09	279.4	77.5	2.09	0.0%	Longer term production growth in Mississippian reserve base, conservative hedging
FINANCIALS																
Dupont Fabros Technology (DFT)	6/4/2012	\$24.97	\$25.25	1.12%	\$2,073.75	4.25%	Dec	1	\$27.00	\$1.92	\$1.52	13.1	16.6	1.04	1.9%	Growth story based on data center exposure, projected RUT Growth weight increase
Och-Ziff Capital Management (OZM)	6/18/2012	\$7.58	\$9.66	27.44%	\$4,017.64	14.86%	Dec	1	\$11.50	\$1.22	\$1.17	7.9	8.2	1.98	4.1%	Recent positive AUM indications, higher beta, insider buying provides additional confidence
HEALTH CARE																
Molina Healthcare (MOH)	3/9/2012	\$33.37	\$25.15	-24.63%	\$1,170.58	12.63%	Dec	1	\$51.00	\$1.50	-\$0.20	16.7	-123.3	1.22	0.0%	Attractively positioned for "dual eligible" opportunity
INFORMATION TECHNOLOGY																
OpenTable, Inc (OPEN)	8/11/2011	\$65.48	\$41.60	-36.47%	\$940.27	6.31%	Dec	1H	\$51.00	\$2.01	\$1.61	20.7	25.9	0.99	0.0%	Secular growth, sizeable market, US leadership, proven model scalability
Bankrate Inc (RATE)	3/20/2012	\$22.92	\$15.58	-32.02%	\$1,557.61	-27.53%	Dec	1H	\$26.00	\$1.06	\$0.81	14.7	19.3	2.11	0.0%	Internet/Tech exposure with end market play on several Financials verticals
Convergys (CVG)	5/21/2012	\$13.44	\$15.67	16.59%	\$1,761.89	22.71%	Dec	1	\$17.00	\$0.95	\$0.84	16.6	18.8	1.37	0.0%	Strong cash reserves, discounted valuation, recently initiated dividend, LBO candidate
Silicon Labs (SLAB)	9/6/2012	\$38.57	\$36.76	-4.69%	\$1,535.39	-15.34%	Dec	1	\$44.00	\$2.23	\$1.95	16.5	18.8	1.23	0.0%	Less volatile semi, confidence in growth, poor sentiment.
Ciena (CIEN)	9/6/2012	\$14.37	\$13.59	-5.43%	\$1,361.75	12.31%	Oct	1H	\$19.00	\$0.76	-\$0.03	17.9	-390.0	2.19	0.0%	Product cycle opportunity should lead to margin expansion, convertible retirement in '13.
INDUSTRIALS																
WESCO International (WCC)	12/19/2011	\$48.92	\$57.20	16.93%	\$2,501.12	7.90%	Dec	1	\$72.00	\$5.50	\$4.80	10.4	11.9	1.91	0.0%	Leader in NA electrical products distribution, share gains in depressed utility/nonresidential
Kelly Services Inc (KELYA)	2/6/2012	\$15.93	\$12.60	-20.90%	\$470.27	-7.89%	Dec	1H	\$17.00	\$1.43	\$1.28	8.8	9.8	1.68	1.2%	Improving core margins can drive EPS growth despite slow macro growth
United Rentals Inc (URI)	7/30/2012	\$29.17	\$32.71	12.14%	\$3,066.08	10.69%	Dec	1	\$46.00	\$4.35	\$3.10	7.5	10.5	2.50	0.0%	Attractive valuation and risk/reward on strengthening non-resi and construction/industrial
UTILITIES																
Great Plains Energy (GXP)	5/21/2012	\$19.90	\$22.26	11.86%	\$3,415.37	2.20%	Dec	1	\$26.00	\$1.65	\$1.34	13.5	16.7	0.70	3.8%	Discounted valuation, turnaround story with solid underlying earnings trends

Note: Portfolio performance based on daily index level as calculated by Russell indices; index performance incorporates historical constituent changes and is measured using daily close prices.
 Price added is prior day's close when stock is added b/f market open. Price added is same day close when stock is added after market open. Methodology generally mirrors that used to calculate the S&P equal weighted index.
 A full history of changes to our model portfolio is available upon request. No transaction costs are assumed. Past performance not indicative of future performance. FFOPS used instead of EPS for REITs. Data is calendarized.

Source: Citi Research, S&P Global Indices, Bloomberg, FactSet, Russell

Appendix A-1

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