Dresdner RCM Global Investors

Quarterly Investment Strategy Sheet

Fourth Quarter 2000

U.S. Small Cap Growth Equity

▶ Market Environment

Clear evidence of a slowdown in the U.S. economy, an acceleration of earnings disappointments, and heightened volatility characterized the investment environment over the fourth quarter. Many high-profile firms across industries announced downward earnings revisions for 2001, which had an immediate knock-on effect on smaller firms. The market quickly extrapolated the likely impact of slowing demand and lower capital expenditures on the prospects of related companies in the small cap sector.

Equity markets rewarded momentum strategies during most of 1999 and the first quarter of 2000. Investing in companies with earnings was not always the most profitable strategy. By the beginning of the fourth quarter 2000, however, market participants had begun to re-assess the prospects of technology and other high-growth companies in the context of a slowing economy, with a renewed interest in earnings stability. In retrospect, one could easily challenge the notion that the market always prices equities correctly, given the vastly different character of investor sentiment during the first and fourth quarters.

The uncertainties surrounding the economy as a whole led investors to seek the relative safety of stocks whose P/E multiples were less dependent upon high-growth assumptions. As a result, value stocks in virtually every market cap segment posted their first year ahead of growth stocks since 1997. The value subset of the Russell 2000 Index beat its growth counterpart by just over 45% in 2000, with an overwhelming portion of this lead chalked up during the fourth quarter. This quarter witnessed the greatest outperformance of the Russell 2000 Value Index over the Russell 2000 Growth Index since the inception of these indices in 1979.

However, in the midst of this change in sentiment, we noticed that many profitable companies with strong balance sheets, access to capital, and sound growth prospects sold off nearly as heavily as less sound companies with weaker balance sheets and questionable access to funding. We used this volatility to switch into and accumulate the highest quality growth companies in each industry in our investment universe.

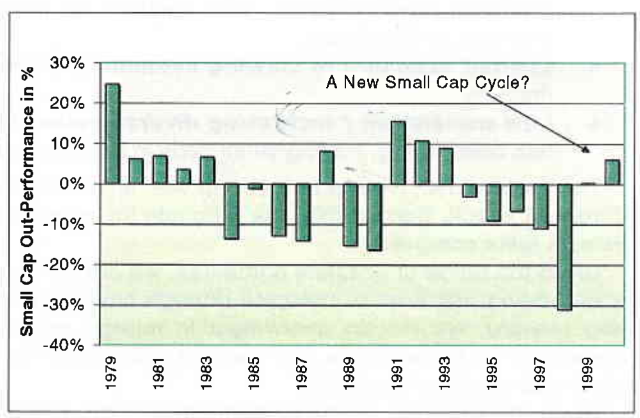
As we move into 2001, we note a widening disparity of views in the financial press on the vital question, "How abruptly will the U.S. economy slow, and will it fall into recession?" The revised third quarter gross domestic product (GDP) growth of 2.2% was less than half the second quarter's 5.6% rate, and economists are divided on whether the economy will actually contract, or whether it will merely stabilize at a lower, but more sustainable long-term growth rate.

On January 3, the Federal Reserve surprised the markets with a 50-basis point, inter-FOMC meeting cut in its key Fed funds rate to 6%. The Fed has tipped its hand that it is ready and willing to do what it perceives is necessary to prevent the U.S. economy from slowing too rapidly. While the past is never a sure guide to the future, history suggests that small cap stocks tend to do well over the course of an easing cycle.

Relative P/E of Russell 2000 Index vs. S&P 500 Index

Source: Dresdner RCM Quantitative Analytics; Frank Russell Data Services†

Small Cap (Russell 2000) minus Large Cap (S&P 500) Performance



Source: Dresdner RCM Quantitative Analytics; Frank Russell Data Services

†Large Cap represented by the S&P 500 Index. Small Cap represented by the Russell 2000 Index. P/E based on IBES FY1 EPS estimates. Data through December 31, 2000.

▶ Portfolio Review

The Russell 2000 Growth Index posted only four positive months in 2000: February, June, August, and December. Dresdner RCM Small Cap portfolios outperformed in each of these months by an average of around 1000 basis points. The portfolios' significant year-to-date lead over the index as of September 30th was eroded during two difficult months in October and November. During this period, the Russell 2000 Value Index outperformed the Russell 2000 Growth Index by a greater margin than over any other two consecutive months since inception of the indices in January 1979. This coincided with broader equity market concerns. Small caps rarely lead during a market correction.

Most portfolios finished the year very close to the benchmark's decline of 22.4%. During the fourth quarter, client portfolios fell around 29%, relative to the Russell 2000 Growth's 20.2% fall. Stock selection in health care equipment, including Invitrogen Corporation and Cytyc Corporation, helped returns.

However, the market's risk aversion to high-growth companies within software, as well as semiconductors related to the telecommunication industry, hurt performance. Industry strategy, largely a result of our bottom-up portfolio construction process, added to performance via our overweight position in energy and underweight position in internet software. It hurt our performance via our underweight in health care providers and overweight in telecommunication services.

We believe the market has already priced in a substantial risk premium. Many small cap stocks have returned to historically attractive valuation levels. The flight to larger, more liquid names has given us the opportunity to evaluate a wider range of companies and upgrade portfolio holdings into higher quality names, including some which were previously mid cap stocks.

Stock Highlight: Invitrogen Corporation (IVGN) supplies research tools in kit form to corporate, academic, and governmental entities. The research kits simplify and improve gene cloning and gene analysis techniques. These techniques are used to study how a cell is regulated by its genetic material, known as functional genomics, and to search for drugs that can treat diseases. Invitrogen's products allow researchers to perform these activities more accurately and with greater reproducibility compared to conventional research methods.

We like the company for several reasons. It has a successful track record and is a market leader in the segments it serves. It is profitable and has enjoyed strong revenue and earnings growth. Gene cloning and analysis kits represent a rapidly emerging segment of the molecular biology product and supply market, with strong sales growth potential due to increased government interest and new data from the Human Genome Project. There are high barriers to entry, protecting Invitrogen's position. Its management team, in our opinion, has proven to be capable, and has performed admirably in managing growth, both organically and via logical acquisitions. Its revenue stream is diversified, as it serves research efforts in the pharmaceutical/biotechnology, agricultural, government and academic communities. IVGN's share price performance over the quarter was 21.4%.

▶ Outlook

During the five years from 1994 to 1998, large caps outperformed small caps. Beginning in 1999, small caps started to outperform large caps. There are numerous factors that could have an impact on whether this small cap cycle will continue and accelerate. While we remain cautious and expect volatility to continue, recent developments provide a basis for measured enthusiasm in 2001. Key reasons supporting the case for small caps include:

- **The Fed's monetary stimulus:** We appear to be at the beginning of a significant easing cycle.
- **Very low valuations vs. large cap stocks:** Small caps have corrected to the point of offering compelling valuation characteristics. Their relative valuations are near their 20-year lows, selling at a substantial discount to large caps.
- **Limited exposure to slowing economies overseas:** Small caps are generally less exposed to non U.S. markets.
- **Low correlation / increasing diversification benefits:** The correlation between large and small stocks has been falling. Having small caps in a primarily large cap portfolio may improve the risk/return profile.

The greatest risk we see to a strong year ahead for small caps centers on a full-blown recession, or some presently unforeseen shock. Barring this, the rationale for small cap stocks, which typically capture most of their returns in short bursts, is quite compelling.

Given the range of possible outcomes, we are concerned less with predicting the exact economic scenario than we are with being prepared to navigate through changing environments, taking advantage of dynamic market conditions. Going forward, we remain overweight in energy and in some areas of technology, including software. We remain underweight in those areas we feel are vulnerable to a slowing economy, including consumer discretionary and commercial goods and services.

Given the apparent strong fundamentals in the small cap sector, appealing valuations and reasonable prospects for a return to more stable economic conditions in 2001, small cap growth stocks continue to play a constructive role in diversified equity portfolios.