

Portfolio Review: U.S. Equity Value Fund

Second Quarter 2010



BROWN ADVISORY

Portfolio Review and Outlook

After a strong stock market recovery and rising expectations, renewed concerns over the financial health of Europe and the daily grind of the Gulf oil tragedy made for an abrupt reversal in both investor attitude and stock prices during the second quarter. Notwithstanding the high quality global nature and low absolute valuation of our portfolio, we posted negative returns for the quarter and were also slightly below the broad benchmarks.

Our key investments in the energy and technology industries were hardest hit. The largest loss was in Transocean, the world's leading rig company. Our investment thesis for Transocean rested on its ability to sustain acceptable returns during the downturn, to better manage capital deployment and to exceed expectations that appeared too pessimistic. The Company performed well until the accident. Our downside risk case had assumed low activity and prices, but we had not assumed a catastrophic loss that continues to linger with an unknown liability. Given the uncertain legal and political costs, we elected to sell our position in favor of other depressed energy investments.

Although government actions are designed to restart the credit cycle via bank support, zero interest rates, and consumer

spending incentives, we believe that they will not, nor should not, be especially successful. What is needed, from our common sense perspective, is time. As such, we believe the reward/risk ratios for many credit-based financials and consumer discretionary stocks remain unattractive.

We remain confident in the fundamentals of the companies in the portfolio. Their leadership position, global orientation, innovative culture, strong financial condition and absolutely low valuations should offer the potential for solid long-term returns with a manageable level of risk. Whereas global economic realities may mean that the future is very different from our postwar experience, we have been especially circumspect about what growth may look like and remain especially vigilant with respect to the risks we are willing to assume.

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Sector Diversification vs. Russell 1000 Value Index

- R&D based product development cultures, global reach and strong finances support our considerable investment in industrials, materials and technology companies.
- Favorable long-term supply/demand fundamentals and low expectations define the energy sector's attractiveness.

Sector	Q2 '10	Benchmark	Diff	Q1 '10	Q2 '09
Consumer Discretionary	--	7.17	-7.17	2.89	4.05
Consumer Staples	5.21	10.57	-5.36	3.20	6.22
Energy	18.24	10.56	7.68	17.49	13.24
Financials	17.32	28.68	-11.36	17.18	19.16
Health Care	14.44	13.45	0.99	12.58	10.63
Industrials	17.58	8.82	8.76	22.79	22.34
Information Technology	20.25	5.52	14.73	16.28	13.89
Materials	6.96	2.92	4.03	7.60	10.46
Telecommunication Services	--	4.95	-4.95	--	--
Utilities	--	7.37	-7.37	--	--

N.B.: Figures may appear not to add up due to rounding.

Source: Brown Advisory

Benchmark: Russell 1000 Value

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Quarterly Attribution Detail by Sector vs. Russell 1000 Value Index

Sector	Portfolio		Russell 1000 Value		Attribution Analysis			
	Average Weight	Total Return	Average Weight	Total Return	Allocation Effect	Selection Effect	Interaction Effect	Total Effect
Consumer Discretionary	1.56	-4.87	10.66	-12.07	0.14	-0.19	0.16	0.10
Consumer Staples	4.37	-2.14	5.70	-7.13	-0.13	0.25	-0.04	0.07
Energy	17.60	-22.79	17.33	-12.28	-0.05	-2.04	0.17	-1.92
Financials	17.04	-5.13	26.32	-12.80	0.20	1.96	-0.72	1.43
Health Care	13.35	-10.86	8.52	-11.62	0.00	0.09	0.00	0.09
Industrials	19.75	-10.51	10.77	-14.03	-0.21	0.40	0.32	0.50
Information Technology	18.84	-16.70	5.06	-12.47	-0.21	-0.23	-0.74	-1.19
Materials	7.48	-5.30	4.02	-14.85	-0.13	0.37	0.34	0.58
Telecommunication Services	--	--	5.04	-5.43	-0.27	--	--	-0.27
Utilities	--	--	6.57	-3.36	-0.50	--	--	-0.50
Total	100.00	-12.25	100.00	-11.16	-1.16	0.61	-0.50	-1.09

Allocation Effect: Measures the impact of the decision to allocate assets differently than those in the benchmark.

Selection Effect: Measures the effect of choosing securities that may or may not outperform those of the benchmark.

Interaction Effect: Measures the effect of allocation and selection decisions, i.e. did we overweight the sectors in which we underperformed.

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Quarterly Attribution Detail by Sector vs. S&P 500 Index

Sector	Portfolio		S&P 500		Attribution Analysis			
	Average Weight	Total Return	Average Weight	Total Return	Allocation Effect	Selection Effect	Interaction Effect	Total Effect
Consumer Discretionary	1.56	-4.87	10.25	-10.67	0.03	-0.30	0.24	-0.03
Consumer Staples	4.37	-2.14	11.17	-8.13	-0.18	0.63	-0.39	0.06
Energy	17.60	-22.79	10.93	-12.75	-0.06	-1.17	-0.64	-1.86
Financials	17.04	-5.13	16.65	-13.43	0.02	1.33	0.01	1.36
Health Care	13.35	-10.86	11.76	-11.78	0.07	0.12	0.01	0.20
Industrials	19.75	-10.51	10.62	-12.27	-0.03	0.20	0.19	0.36
Information Technology	18.84	-16.70	18.76	-12.31	-0.03	-0.90	-0.09	-1.02
Materials	7.48	-5.30	3.49	-14.98	-0.14	0.33	0.40	0.59
Telecommunication Services	--	--	2.83	-4.24	-0.20	--	--	-0.20
Utilities	--	--	3.54	-3.77	-0.27	--	--	-0.27
Total	100.00	-12.25	100.00	-11.43	-0.79	0.25	-0.27	-0.82

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Quarterly Contribution to Return

- All of these top contributors are stocks that were purchased during periods of specific earnings concerns. Their downside risk was limited by both their depressed valuations and their franchise quality.
- Our scenario-based reward/risk framework has served us well in most situations, especially high-frequency, low-severity ones. It did not help us with respect to Transocean, as catastrophic accidents like the Horizon disaster are a very low-frequency, high-risk affairs. Consistent with our investment philosophy, we continued to add to most of the laggards. Simply put, lower prices plus an unchanged investment thesis produces even better reward/risk ratios.

Top Five Contributors

	Name	Avg. Weight	Total Return	Contribution to Return
SHW	Sherwin-Williams Co.	0.89	11.92	0.17
NSC	Norfolk Southern Corp.	1.52	-4.53	0.06
DRI	Darden Restaurants Inc..	0.68	-1.29	0.05
MTB	M&T Bank Corp.	1.17	1.23	0.03
OII	Oceaneering Int'l Inc..	0.33	2.39	0.03
	Total	4.59	1.59	0.33

Bottom Five Contributors

	Name	Avg. Weight	Total Return	Contribution to Return
RIG	Transocean Ltd.	2.44	-45.80	-1.52
MSFT	Microsoft Corp.	2.89	-21.08	-0.76
MDT	Medtronic Inc.	3.69	-19.08	-0.75
TOT	Total S.A. ADS	3.36	-21.06	-0.68
BK	Bank of New York Mellon	3.34	-19.82	-0.68
	Total	15.72	-25.77	-4.38

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Source: Brown Advisory

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Key Additions/Deletions

Additions

- **CA Inc.** is a rehabilitated, financially strong company that serves the core mainframe market; a low-growth, high-return market that we believe has the potential to surprise in the new world of cloud computing. It also has a sizable variety of ancillary businesses whose return profile should be substantially higher. Success should mean a long period of rising sales expectations and higher margins. We believe that failure is already priced into this inexpensive stock. New management is making steady progress.
- **McCormick & Company Inc.** is the world's leading spice company, serving both consumers and industry. Sales and margins should continue to benefit from international expansion and restructuring. Cash flow deployment continues to be focused and intelligent. Its financial condition is strong and the valuation is near a record low.
- **National Oilwell Varco Inc.** and **Oceaneering International Inc.** are each global leaders in a critical aspect of oil service technology. They each have strong finances, proven managements, attractive free cash flows and historically low valuations. Although not directly impacted by the Gulf disaster, both companies' stock prices are down some 25-30% since that fateful day.
- **U.S. Bancorp**, one of the country's best managed banks, has low exposure to credit and high fee-based returns. We remain wary of the average credit provider as real estate remains unsettled and credit demand is likely, in our view, to stay at low levels for longer than most expect.

Source: Brown Advisory

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Portfolio Activity

	Additions	Sector
CA	CA Inc.	Information Technology
MKC	McCormick & Co. Inc.	Consumer Staples
NOV	National Oilwell Varco Inc.	Energy
OII	Oceaneering International Inc.	Energy
USB	U.S. Bancorp	Financials

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Key Additions/Deletions

Deletions

- **Darden Restaurants, Jacobs Engineering Group Inc.** and **Sherwin Williams** were all sold due to appreciation.
- **M&T Bank Corp.**, a very rewarding holding, was sold due to its valuation and relatively high exposure to commercial real estate.
- **Sysco Corp.** is a company with less clear prospects and a comparable valuation to McCormick.
- **Symantec Corp.** is an inexpensive stock, but we believe that CA's business positioning and upside are materially better.
- **Staples** was sold so that proceeds were also used to fund better ideas.
- **Transocean Ltd.** was divested due to the uncertainty surrounding the ultimate resolution of the Horizon disaster. Given our favorable long-term view of energy fundamentals, proceeds were used to add to existing energy holdings and two previously mentioned additions, National Oilwell and Oceaneering International, whose downside risks are more known and their attractive reward/risk ratios are more reliable in contrast to Transocean.

Portfolio Activity

	Deletions	Sector
DRI	Darden Restaurants Inc.	Consumer Discretionary
JEC	Jacobs Engineering Group Inc.	Industrials
MTB	M&T Bank Corp.	Financials
SHW	Sherwin-Williams Co.	Materials
SPLS	Staples Inc.	Consumer Discretionary
SYMC	Symantec Corp.	Information Technology
SY Y	Sysco Corp.	Consumer Staples
RIG	Transocean Ltd.	Energy

Source: Brown Advisory

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