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*U.S. SMALL CAP RESEARCH*

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## **Executive Summary**

Investments in small cap securities remain an active and growing area of interest for investors for a number of reasons. Small cap stocks, those with market capitalizations under \$2 billion USD, have a history of providing higher relative returns compared to the rest of the stock market. Additionally, they are known to outperform and recover faster than mid and large cap stocks. For example, since the beginning of 2000 small cap stocks as measured by the S&P 600 have risen 69%, or 7% per year, compared to the large cap oriented S&P 500 which has fallen 24% over this same time frame. And while the S&P 500 has gained approximately 59% since market lows in March of 2009, the Russell 2000 has grown almost 90%. Historical statistics such as these, have led many institutional investors to focus on the small cap segment of the equity markets.

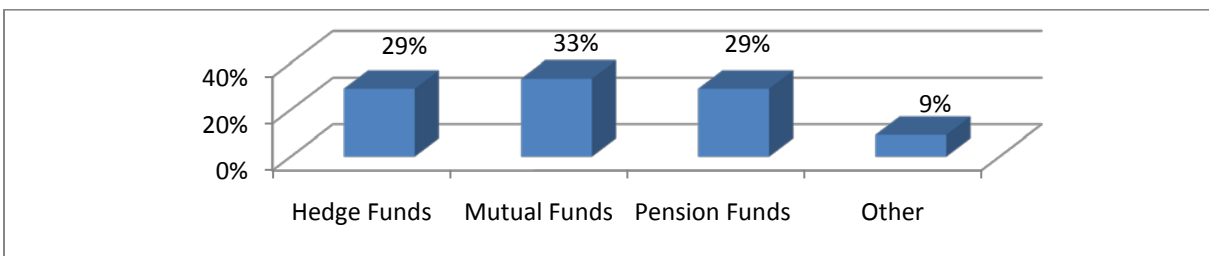
As interest in small cap stocks continues to grow, investors are continuously seeking additional sources for small cap research, particularly in-depth research produced by knowledgeable, well experienced analysts who produce company or industry insights. For this ResearchFocus report, Integrity Research has developed a comprehensive guide to assist investors in identifying high quality small cap research providers in various sectors of the market.

Integrity Research Associates considers a research firm a small cap specialist if 45% or more of companies covered by that firm have market capitalizations under \$2 billion USD. In this report, we look at and provide in-depth analysis on the top 26 small cap specialists. Additionally, Integrity has analyzed firms that cover more than 100 U.S. small cap companies, irrespective of what percentage of total coverage small caps represent. The larger bulge bracket investment banks typically fall into this category of firms. In this report, Integrity provides small cap analysis of the small cap research provided by 9 large investment banks. In total, Integrity Research provides in-depth analysis on 35 firms, though we some offer information on a total of 46 small cap research providers

### **Integrity's Small Cap Research Survey**

To evaluate U.S. small cap research providers, Integrity went to the most logical source - the investors that use the research. In the 4<sup>th</sup> Quarter of 2009, we surveyed 141 portfolio managers and analysts from pension funds, hedge funds, and mutual funds in the United States to analyze what type of research the buy-side values, and who they consider to be their top small cap research providers in various sectors. Among the 141 survey participants, 33% of the respondents were mutual funds, 29% hedge funds, 29% pension funds and 9% other.

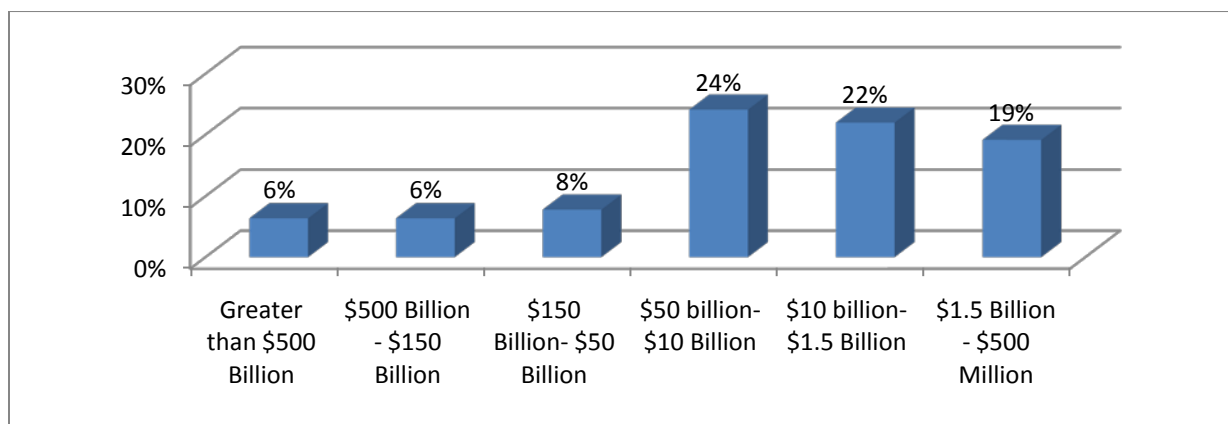
**Chart 1 - Buy-Side Survey Participants**



n= 141, Source: Integrity Research Associates 4<sup>th</sup> Qtr 2009 Small Cap ResearchFocus Survey

Respondents represented a broad cross-section of assets under management, ranging from US\$500 million to greater than US\$500 billion. Many of the respondents came from larger institutions, with the midpoint in the \$10 billion to \$50 billion range. The total AUM of all respondents who participated in our survey was \$12.5 trillion.

**Chart 2 -Assets Under Management**



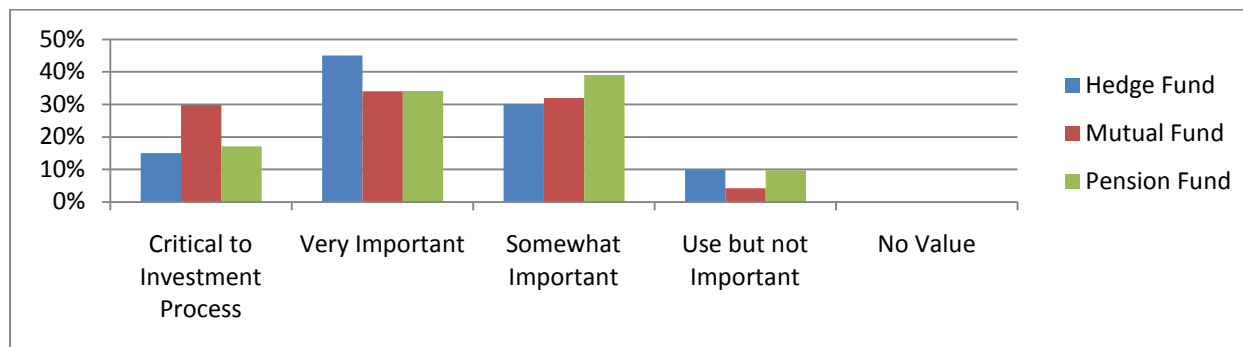
n= 141, Source: Integrity Research Associates 4<sup>th</sup> Qtr 2009 Small Cap ResearchFocus Survey

**Small Cap - Trends**

Section 2 of this report explores the current trends in U.S. small cap research, based largely on an analysis of the results of Integrity’s 4<sup>th</sup> Quarter 2009 buy-side survey.

Among the 141 buy-side investors surveyed, all believed that external fundamental research holds at least some value in their small cap research process. 21% of participants believed it to be *Critical to the Investment Process*; 31% *Very Important*; 37% *Somewhat Important*; 11% *Use But Not Important*; and 0% *No Value*.

**Chart 3 - Value of External Fundamental Research**



How important is external fundamental research to your investment process in small cap stocks?  
 n=141, Source: Integrity Research Associates 4<sup>th</sup> Qtr 2009 Small Cap ResearchFocus Survey

Survey participants indicated that the most valued sources for small cap equity research were *Regional Investment Banks* followed by *Bulge Bracket Investment Banks*, *Boutique Investment Banks* and finally *Independent Research Providers*.

We polled survey respondents to determine which factors are most important to them when evaluating small cap research. Participants ranked each of fourteen different parameters on a scale of 1-5, and the three most important metrics were *Quality of Analysts* followed by *Depth of Research Reports* and *Unique Company / Industry Insights*.

We supplemented this with our own analysis of the metrics, examining the correlation of each metric to user satisfaction, and testing the significance of each metric in predicting user satisfaction. The most valued factors held up under this analysis: analyst quality, in-depth reports and company/industry insights remained the most important. However, the analysis reveals that factors that are ranked highly by large cap investors--such as access to company management, conferences, and financial models-- are relatively insignificant in predicting user satisfaction with U.S. small cap research.

### **Top Small Cap Research Firms**

Sections 3 and 4 of the report focus on analyzing the top firms in U.S. small cap research, as identified by the buy-side. Firms cited by survey respondents were ranked and analyzed to determine the top research firms based on Popularity, Overall Satisfaction, as well as fourteen individual research value metrics.

Drawing on our analysis of the factors which determine user satisfaction with small cap research, Integrity constructed a model for selecting the top small cap research providers. The analysis was applied to eight industry sectors - *Energy*, *Basic Materials*, *Industrials*, *Consumer Goods & Services*, *Healthcare*, *TMT*, *Financial Services* and *Generalists*- to identify the top small

cap researchers in each sector. Then the sector level analysis was aggregated to select the 2010 Overall Top Picks for U.S. Small Cap Research among boutique & regional banks and independent providers. A separate analysis was performed on large investment banks, which offer small cap coverage but are generally not as highly valued for their small cap coverage as other types of providers.

The 2010 edition of Integrity's ResearchFocus report features information and analysis on a total of 46 small cap research providers, ranging from large investment banks to small boutiques. In-depth analysis is provided for 35 of these firms. Based on the analysis of our 4<sup>th</sup> quarter 2009 buy-side survey, and our expertise in the research space, we expect that interest in small cap stock investments will only continue to grow. With so many options on where to turn for high quality small cap research, this report serves as the go to source to find the best fit for your specific needs and interests.