Small-Mid Cap Core Portfolio **Manager Commentary**

2nd Quarter 2008

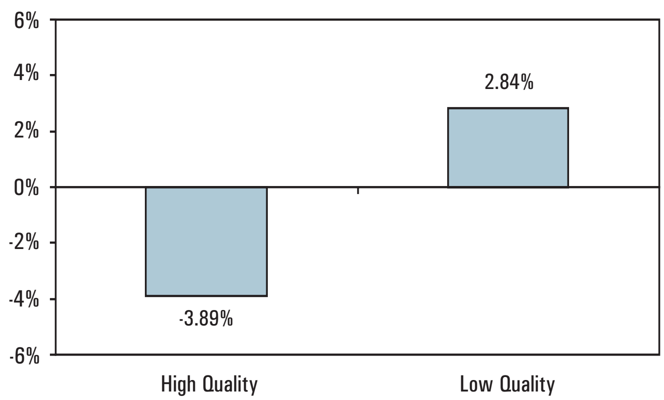
Market Overview

After rallying during April and May to erase much of the markets' first-quarter declines, the markets experienced one of the worst (if not the worst for certain indexes) monthly returns in history for the month of June. The markets continue to be affected by the slowing economy, persisting credit problems, and rising inflation. For the quarter, the Russell Midcap Index rose 2.67%, outperforming both the Russell 2000 Index (+0.58%) and the S&P 500 Index (-2.73%). Growth significantly outperformed value during the quarter, with the Russell 2000 Growth Index up 4.47% versus the Russell 2000 Value Index down 3.55%. Year to date through the second quarter, all equity indexes, regardless of asset class, were down in the high single-digit to low double-digit range.

Reflecting record high oil prices, energy was the strongest performing sector by a wide margin, increasing more than 30% in every small and mid-cap Russell index. Financial services was among the worst performers, continuing the trend experienced for several quarters, along with transportation and consumer staples, which were both impacted by higher commodity prices.

Low-quality stocks, as measured by S&P Quality Rankings, held up substantially better than high-quality stocks during the quarter (See chart: *Performance by S&P Quality Rankings*). Although high-quality should intuitively outperform in this type of market environment, high quality underperformed due to the large weighting of banks in the high-quality segment of the benchmarks, which were down considerably during the quarter. Excluding financials, the performance between high and low quality appeared more balanced. However, in the sectors where low quality outperformed, it was by a greater magnitude than in the sectors where high quality outperformed.

Performance by S&P Quality Rankings
Russell 2500™ Index



Data is obtained from FactSet Research Systems and is assumed to be reliable.
Past performance is no guarantee of future results. Data is for the second quarter 2008.
High Quality - Stocks in the Russell 2500™ Index with an S&P quality ranking of A- or higher.
Low Quality - Stocks in the Russell 2500™ Index with an S&P quality ranking of B or less.

Portfolio Overview

The Small-Mid Cap Core Portfolio underperformed the Russell 2500 Index for the quarter. The underperformance was driven by the aforementioned performance of low quality during the quarter and by the strong performance of the energy sector. Besides the portfolio's underweight in energy, the Small-Mid Cap Core Portfolio's energy holdings did not keep pace with those in the benchmark due to the types of energy companies that we own. Given our high-quality orientation, we own companies that have less direct exposure to the underlying price of the commodity in order to protect the portfolio against the price volatility. In this environment, these types of energy companies did not perform as strongly as those with more direct exposure to the commodity, such as oil producers and drilling companies.

"At this point in the cycle, we believe owning a diversified portfolio of companies with a high return on equity, strong balance sheets, and above market earnings growth is a prudent strategy."

– Robert Schwarzkopf, CFA Chief Investment Officer & Portfolio Manager
– Sandi Gleason, CFA Portfolio Manager
– Craig Stone Portfolio Manager

The companies that contributed the most to performance during the quarter included Eaton Vance and Digital River. Eaton Vance, an investment management firm, reported strong growth in assets under management during the quarter, allaying investor concerns about the challenging financial-market environment, in general, and disruptions in the closed-end fund market, in particular. The company also took aggressive steps to mitigate its exposure to the auction-preferred securities problems that negatively affected the closed-end fund market. Digital River builds and operates online stores on an outsourced basis. The company is a key beneficiary of the shift within the software industry to online distribution, currently only 19% of software sales to consumer and small and medium-size businesses. As the largest player in the industry, serving over half the electronic-software download market, Digital River generates additional growth by leveraging its expertise into areas such as online consumer electronics sales and internet computer games.

Companies contributing the least to performance during the quarter included UCBH Holdings and Pediatrix Medical Group. UCBH reported highly disappointing first quarter 2008 results, driven by a dramatic deterioration in loan quality. We initially entered the stock when UCBH primarily acted as a lender to the low-risk commercial real estate market (apartment, owner-occupied, and income producing properties) and boasted a long track record of serving an attractive, fast-growing niche segment of the ethnic Chinese population. Recently, however, UCBH rapidly expanded into higher risk construction within the commercial and industrial segments. Construction loans advanced 50% between the first quarter of 2007 and the first quarter of 2008, sourcing the company's dramatic deterioration in problem loans. The shares of Pediatrix Medical Group, the largest neonatal practice management company in the nation, suffered due to weakening birth rates. Nonetheless, we believe the important advantages of the business, particularly the hospital-derived patient relationship, as well as its ability to generate superb returns on capital remain intact.

Purchases and Sales

In the Small-Mid Cap Core Portfolio, we purchased Landstar System, RPM International (RPM), and increased our position in Teleflex, while we sold our positions in Bemis Company, Jackson Hewitt Tax Service, and Zebra Technologies.

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1800 Avenue of the Stars, Second Floor • Los Angeles, California 90067 • (800) 231-7414
visit our Web site: www.kayne.com or contact us via e-mail: info@kayne.com

Landstar System is a leading non-asset based business services company that provides transportation solutions to shippers throughout the Unites States. These services are delivered through a network of independent sales agents and independent truck owner operators that Landstar calls business capacity owners (BCOs) linked together by a series of innovative technological applications utilizing the Internet and wireless communications. Landstar is differentiated by its unique capability to arrange a wide range of specialized transportation services quickly through its people and technology network. Due to its overall asset-light business model, Landstar achieves a very high return on equity. The company has also been a consistent repurchaser of its own stock. The company generates very strong free cash flow and should be able to continue share repurchases at similar paces going forward.

RPM provides specialty coatings encompassing over 100 brand name products for general maintenance, waterproofing, roofing systems, sealants, floor coatings, and corrosion control. Leading consumer brands include Rust-Oleum, Bondex, Zinsser, Testors and Bondo. Leading industrial brands include Day-Glo, Carboline, Mathy's Mohawk, and Tremco. The company has been a consolidator in the industry and has been able to leverage the acquisitions through their distribution channel, including the do-it-yourself channel of Home Depot and Lowe's. Initially, RPM had left their acquisitions as independent operating units. This left the benefits of scale economics unharvested. RPM is now integrating their acquisitions with good success. The operating business continues to do well with double-digit earnings growth with continued good demand for its well-known name products, despite the commodity price headwind that RPM and the rest of the industry faces. RPM's well-known brand names give the company more pricing power than others in the industry. Trading at an attractive valuation, we decided to purchase the stock.

Teleflex declined year to date (as of the initiation of the increase) as the company's integration of its acquisition, medical-device company Arrow, that closed in October last year is ongoing. Once complete, the acquisition will transform this industrial company with a small medical-device business to a medical-device business with a small industrial segment. Longer term, we believe that investors will come to appreciate the potential of Teleflex for its majority medical-device business that has a higher recurring revenue component due to its disposable nature and higher profit margin. In addition, the company will be better able to weather economic downturns due its smaller industrial business.

Purchases During the Quarter

	Quality		Growth		Value
	5-Year Avg. ROE	Long-Term Debt to Capital	5-Year Avg. EPS Growth	Capital Generation	Trailing 12-Mo. P/E Ratio
Landstar System	41.6%	28.7%	24.6%	39.3%	20.0x
RPM International	8.6%*	42.7%	9.5%*	5.3%*	13.6x
Russell 2500™ Index	14.1%	42.9%	16.6%	11.7%	19.7x

** Includes 10-year liability reserve.*
Company data as of the date that the purchase program was initiated. Benchmark data as of March 31, 2008.
Source: Major consulting firm, Bloomberg, and FactSet Research Systems
Past performance is no guarantee of future results.

Bemis is a global manufacturer of flexible packaging and pressure sensitive materials. The rapid rise in energy prices over the past 18 months hurt Bemis' margins because oil-derived resin prices, one of the largest input costs for the company, quickly escalated. Bemis will face continuing headwinds from high input costs, along with curtailed end customer demand, as consumers have migrated to lower value-added packaging from high value-added packaging due to the weakening economy along with inflationary pressures for food costs. Consequently, we sold Bemis to fund the purchase of RPM.

Jackson Hewitt is a leading provider of tax-preparation services to the general public in the United States. On January 3, 2008, the IRS issued an advance notice of proposed rulemaking relating to Refund Anticipation Loans (RALs). The notice indicated that the IRS is considering restricting tax preparers' ability to market RALs to clients. Jackson Hewitt gets approximately 25% to 30% of its revenues and a higher percentage of profits from such financial products. Further, the company reported earnings that were well below consensus in Q1 with lower returns prepared, partially due to a lack of pre-season loan product that had been a key customer retention tool for the company. At the same time, industry office expansions have lowered the total returns per office. Theses statistics indicate that despite aggressive expansion efforts, the three large industry competitors are not gaining share from independents, but rather are cannibalizing from existing stores. The whole tax-preparation industry is facing competition from the Free File Alliance, a group of private companies that offers free federal tax filing to tax payers below a certain income threshold as well as the increasing use of software vendors, such as Turbo Tax and Tax Cut. With limited upside potential, a majority of our original reasons for purchasing the stock deteriorated in validity, and the franchise value of Jackson Hewitt diminished, we sold our position.

Zebra Technologies is the worldwide leader in thermal bar code printers. The stock rebounded from a low reached earlier in the year as the result of a new management team, margin improvement, and the growth of sales from new products. Nevertheless, we remain concerned that the core business that produces high margins and return on capital has matured. We sold our position to fund the purchase of another technology company that will be completed during the third quarter.

Outlook

Inflationary concerns, driven by the cost of oil rising to over $140 per barrel, are limiting the Federal Reserve's ability to further lower interest rates to stimulate the economy. Globally, higher inflation is leading policy makers to implement policies to slow growth. This should lead to a decrease in demand for commodities over time and, if past cycles repeat, lower prices. At this point in the cycle, we believe owning a diversified portfolio of companies with a high return on equity, strong balance sheets, and above market earnings growth is a prudent strategy.

Portfolio Characteristics

Quality	KAR Small-Mid Cap Core	Russell 2500™ Index
Return on Equity—Past 5 Years	20.1%	14.0%
Interest Expense Coverage	6.9 x	5.0 x
Earnings Variance—Past 10 Years	45.5%	77.0%
S&P Stock Ranking (A+, A, A-)	43.0%	13.0%
Growth		
Earnings Per Share Growth—Past 10 Years	18.6%	10.8%
Dividend Per Share Growth—Past 10 Years	13.9%	7.1%
Capital Generation—(ROE x {1-Payout})	17.1%	11.8%
Value		
P/E Ratio—Trailing 12 Months	18.6 x	20.0 x

Data is obtained from Bloomberg, FactSet Research Systems, and a major consulting firm, and is assumed to be reliable. Other principal consultant firms may use different algorithms to calculate selected statistics. Data is as of June 30, 2008.

As always, we endeavor to manage your portfolio with the highest quality businesses, outgrowing their markets, purchased at discount values.

The Russell 2500™ Index is a market capitalization-weighted index of the 2,500 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The S&P 500® Index is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The Russell Midcap® Index consists of the smallest 800 securities in the Russell 1000® Index, as ranked by total market capitalization. The Russell 2000® Index measures small-company stocks. Performance is calculated on a total-return basis with dividends reinvested. These indexes are unmanaged and not available for direct investment.

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