



# Lazard

## U.S. Small-Mid Cap Equity Portfolio

### About the Portfolio

#### Symbol

LZSCX (Institutional)  
LZCOX (Open)

#### CUSIP

52106N509 (Institutional)  
52106N780 (Open)

#### Benchmark

Russell 2500 Index

### A Single-Source U.S. Small-Mid Cap Equity Opportunity

- Invests in a wide opportunity set from which the Portfolio management team (the “Team”) seeks to provide strong performance results in different market environments and long-term capital appreciation
- Focuses on what the Team believes are the most attractive opportunities across the entire Russell 2500 universe
- Leverages Lazard’s deep research capabilities, which allows for broad-based idea sourcing

### Portfolio Overview

The Lazard U.S. Small-Mid Cap Equity Portfolio (the “Portfolio”) invests in financially productive small- and mid-cap companies with attractive valuations. The Portfolio seeks to outperform the Russell 2500 Index in all market environments by leveraging the firm’s broad and deep research capabilities to identify the most attractive opportunities across this diverse investment universe. The Portfolio will typically own 70-90 investments at any given time.

*Equity securities will fluctuate in price; the value of your investment will thus fluctuate, and this may result in a loss. Small- and mid-capitalization stocks may be subject to higher degrees of risk, their earnings may be less predictable, their prices more volatile, and their liquidity less than that of large-capitalization or more established companies’ securities.*

*The Portfolio’s investment strategy may involve high portfolio turnover. A portfolio turnover rate of 100%, for example, is equivalent to the Portfolio buying and selling all of its securities once during the course of the year. A high portfolio turnover rate (such as 100% or more) could result in high brokerage costs and an increase in taxable capital gains distributions to the Portfolio’s shareholders.*

*The Portfolio invests in stocks believed by Lazard to be undervalued, but that may not realize their perceived value for extended periods of time or may never realize their perceived value. The stocks in which the Portfolio invests may respond differently to market and other developments than other types of stocks.*

*The Russell 2500 Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as “smid” cap. The Russell 2500 Index is a subset of the Russell 3000 Index. (The Russell 3000 Index measures the performance of approximately 3000 of the largest U.S. companies, representing approximately 98% of the investable U.S. equity market.) It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. The index is unmanaged and has no fees. One cannot invest directly in an index.*

Wherever there’s opportunity, there’s Lazard.<sup>SM</sup>

## Lazard Funds



## Defining the Market Spectrum

The Russell 3000 Index measures the performance of the largest 3,000 companies in the United States. The constituents of the Russell 3000 Index can be broken out into several sub-indices by market capitalization, as shown in Exhibit 1. Exhibit 1 also illustrates the stark differences in the percentage of the Russell 3000 that each sub-index represents in terms of number of stocks and market capitalization.

If managers were to benchmark themselves to the Russell 3000 Index, they would essentially be investing in a large-cap universe: because the market capitalization of the top 1,000 stocks currently makes up over 91% of the market cap of the Index, they would need to narrow their focus on this segment of the market. Conversely, we believe that utilizing the Russell 2500 Index as a benchmark is a more balanced way to participate across the U.S. equity market. The Russell 2500 currently includes over 83% of the investable names in the U.S. equity market, which highlights the diverse opportunity set and flexibility afforded to managers who utilize a broader benchmark. Additionally, the Russell 2500 Index can then serve as a complement to the standard S&P 500 Index benchmark, which consists exclusively of large-cap stocks.

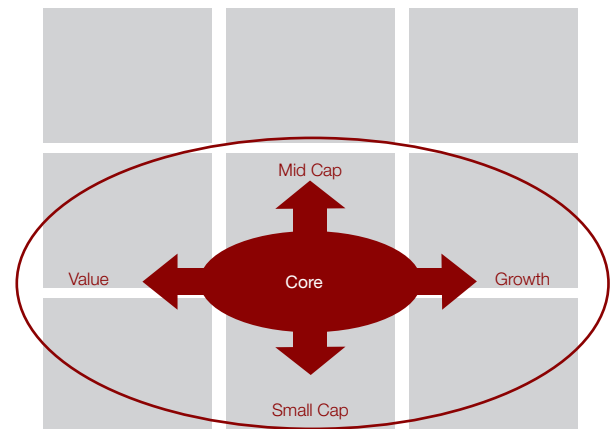
## Finding a Broad-Based Solution for the Small-Mid Cap Market

The Russell 2500 universe is a natural complement to the S&P 500 universe, and this combination provides full U.S. equity market exposure as defined by the Russell 3000 Index. These distinct opportunity sets provide managers a wide universe as they seek to generate returns for investors.

## The Role of an Active Manager in a Broad Mandate

Given the broad nature of the U.S. equity market, it can be segmented into a number of categories. Many investors subscribe to the nine style boxes defined by Morningstar in order to diversify their portfolios. However, as the market continues to evolve, some investors have chosen to group these styles as a “T,” utilizing large-cap value, core, and growth managers to fill the top three boxes, while hiring just one small-mid-cap manager to fill the remaining six boxes (or the stem of the “T”). This concept is illustrated in Exhibit 2. The ability of small-mid-cap managers to move up and down the market-cap spectrum and back and forth across the style spectrum allows them to efficiently cover a much wider range of investment opportunities, thus filling the gap that six different managers might have previously covered.

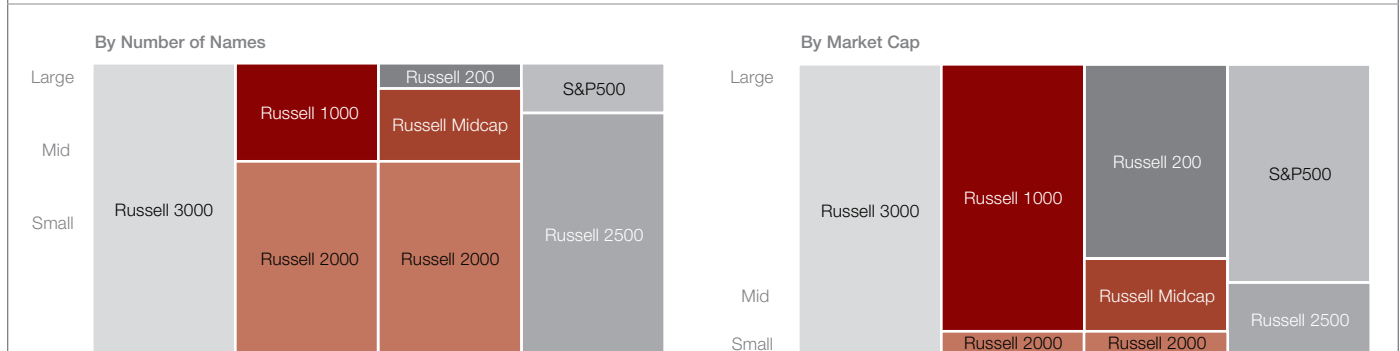
**Exhibit 2: The Style and Size Role of Small-Mid Cap Managers**



As of December 31, 2010  
Source: Morningstar,<sup>1</sup> Lazard

**Exhibit 1: Percentage of Russell 3000 Index by Number of Names and Market Capitalization**

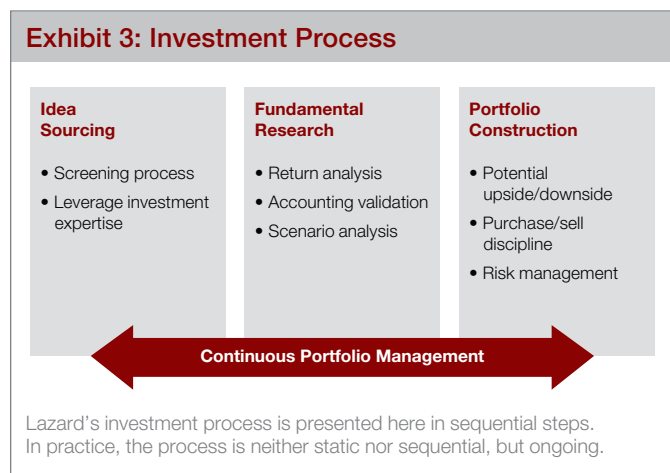
	Russell 1000 Index	Russell Midcap Index	Russell 2500 Index	Russell 2000 Index
Market Capitalization Range (\$M)	251 – 368,712	251 – 38,544	7 – 9,670	7 – 5,169
Weight of Russell 3000 Index (by number of names)	33.3%	26.7%	83.3%	66.7%
Weight of Russell 3000 Index (by market cap)	90.8%	27.8%	19.6%	9.2%



As of December 31, 2010  
Source: Russell Investments, Standard and Poor's

## Investment Process

The Team's philosophy is based on a belief that a bottom-up, fundamental approach to portfolio construction provides an opportunity to exploit market inefficiencies among small- and mid-cap companies to deliver a portfolio with exceptional quality at a reasonable valuation. If we are successful in identifying these opportunities, we believe we can consistently outperform the Russell 2500 Index and the relevant peer group.



The Team seeks to generate excess returns through several different tactics: by recognizing exceptional quality at reasonable valuations; by identifying trough earnings as an opportunistic entry point; by uncovering value through sum-of-the parts evaluation; by taking a longer-term investment view than short-term market participants; and by sourcing ideas across all sectors to improve the Portfolio's upside potential. Key investment characteristics we consider in identifying the companies we will buy include robust free cash flow, financial productivity, balance sheet strength, and attractive valuation.

Because of the depth of our research teams and our disciplined investment process, we believe that a unique element of our Portfolio is the ability to perform in a variety of market environments. We believe that we can perform in markets where small-caps have led, markets where mid-caps have led, value markets, and growth markets. If we are able to identify opportunities in our space, we believe that we can outperform in many different environments regardless of market leadership.

The Lazard U.S. Small-Mid Cap Equity Portfolio, through a disciplined and flexible approach, seeks to add value in each of the three steps of the investment process (see Exhibit 3).

### Idea Sourcing

The Team uses various tools to develop ideas for inclusion in the Portfolio, including quantitative screening specific to each industry, conferences, industry knowledge, analyst experience, supply chain analysis, competitor analysis, and other tools to help discover new ideas throughout the non-large space.

### Fundamental Research

We believe the most reliable source of performance results in this space is security selection, so fundamental research is a critical component. The Team utilizes a robust process focusing on return analysis, accounting validation, and scenario analysis to find companies that have under appreciated future earnings.

### Portfolio Construction

The construction process focuses on building our ideal Portfolio. In order to do this, we constantly compare new ideas with the existing Portfolio, analyze each risk/reward profile to determine the best fit for the Portfolio, normalize opportunities across market cap, industry, and sector based on upside/downside ranking sheets, review scenario analyses to assess price targets, and identify valuation anchors for safety margins. Throughout the process, we seek to maintain a level of sector and industry balance within the Portfolio.

### Continuous Portfolio Management

Continuous Portfolio Management is the daily process of assessing the Portfolio to evaluate consistency with our objectives. We regularly monitor holdings to determine whether valuation opportunities still exist, whether there are better uses of capital, whether weightings reflect our conviction levels, and whether company outlooks remain consistent with our investment thesis. If a company is no longer deemed to be worthy of a position in the Portfolio, this is where the decision is made to sell.

### Why Invest in the Lazard U.S. Small-Mid Cap Portfolio?

- Ability to provide single manager exposure for the six non-large asset allocation segments of the market
- The diverse investment universe of the Russell 2500 Index allows us to target attractive opportunities and seek strong performance results in different market environments
- Deep research capability allows for broad-based idea sourcing

## The Portfolio Management Team



### **Daniel Breslin**

*Director, Portfolio Manager/Analyst*

Daniel Breslin is a Portfolio Manager/Analyst on the U.S. Small-Mid Cap Equity and the U.S. Mid Cap Equity teams, focusing on the Financials, Utilities, Healthcare and interest rate sensitive industries. He began working in the investment field in 1992. Prior to joining Lazard in 2002, Daniel was with Guardian Life and New York Life.



### **Michael DeBernardis**

*Senior Vice President, Portfolio Manager/Analyst*

Michael DeBernardis is a Portfolio Manager/Analyst on the U.S. Small-Mid Cap Equity and Global Small Cap Equity teams with responsibility for coverage of the Consumer Supply Chain and Capital Goods sectors. He began working in the investment industry in 1996. Prior to joining Lazard in 2005, Michael was a Senior Equity Analyst at Systematic Financial Management L.P. and a Market Data Analyst at Salomon Smith Barney.



### **Robert A. Failla, CFA**

*Managing Director, Portfolio Manager/Analyst*

Robert A. Failla is a Portfolio Manager/Analyst on the U.S. Mid Cap Equity, U.S. Small-Mid Cap Equity, U.S. Strategic Equity and U.S. Equity Concentrated portfolio teams. He began working in the investment field in 1993. Prior to joining Lazard in 2003, Robert was a Portfolio Manager with AllianceBernstein.



### **Andrew Lacey<sup>2</sup>**

*Deputy Chairman, U.S. and Global Strategies*

Andrew Lacey is Deputy Chairman of Lazard Asset Management responsible for oversight of the firm's U.S. and global strategies. He is also a Portfolio Manager/Analyst on various U.S. and global equity teams. Andrew began working in the investment field in 1995 when he joined Lazard as a Research Analyst covering the technology sector.

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2 As Deputy Chairman of the Investment Manager, Mr. Lacey is ultimately responsible for overseeing this Portfolio. In addition to his oversight responsibility, Mr. Lacey is a member of the portfolio management team.

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Information and opinions presented have been obtained or derived from sources believed by Lazard to be reliable. Lazard makes no representation as to their accuracy or completeness. All opinions expressed herein are as of the date of this document and are subject to change.

The S&P 500 Index is a market capitalization-weighted index of 500 companies in leading industries of the U.S. economy. The index is unmanaged and has no fees. One cannot invest directly in an index.

The Russell Midcap Index includes approximately 800 of the smallest securities in the Russell 1000 Index, representing roughly 27% of the total market capitalization of Russell 1000 companies. (The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market.) The index is unmanaged and has no fees. One cannot invest directly in an index.

The Russell 2000 Index includes approximately 2000 of the smallest securities in the Russell 3000 Index, representing roughly 8% of the total market capitalization of Russell 3000 companies. (The Russell 3000 Index measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market.) The index is unmanaged and has no fees. One cannot invest directly in an index.

As of August 25, 2008, the Portfolio changed its name from U.S. Small Cap Equity Portfolio and adopted the Portfolio's current investment strategy which compares its performance to the Russell 2500 Index. Prior to August 25, 2008, the Portfolio focused on U.S. small cap companies and compared its performance to the Russell 2000 Index. The Portfolio's benchmark, the Russell 2000/2500 Linked Index, is comprised of the Russell 2000 index from inception to August 24, 2008 and the Russell 2500 index from August 25, 2008 to the present.

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