EMERALD ADVISERS, INC.
2010 4TH QUARTER ECONOMIC & PORTFOLIO COMMENTARY

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MARKET REWARDS BETA TRADE

	4th Quarter 2010	2010 Total Return
Russell 2000 Growth	17.1%	29.1%
Russell 2000	16.3%	26.9%
S&P 500	10.8%	15.1%

The fourth quarter represented more than half of the gain for the year, and was heavily impacted by the market's favorable response to Fed Chairman Bernancke's Jackson Hole speech introducing QE2. The Russell 2000 Growth Index's performance of 29.1% was the best performing space in the domestic universe for 2010.

The year was really broken into 3 different segments. The first part of the year was strong, based on the continuing momentum that started in the Spring of 2009. This huge bounce back of the market stemmed from a change in risk perception and the market's acknowledgement that the economy had indeed bottomed.

The second part of the year was an acknowledgement that after a 1 year bull market run with no corrections, that the market had indeed risen too far and too fast. With this pause, market participants had time to worry about the sovereign debt crisis in Europe and whether the economic stimulus put in place in 2009 would result in a permanent recovery in the United States. Compounding this was healthcare reform and the prospect of financial restraints contained in the forthcoming financial reform bill.

The third part of the year in 2010 was a resumption of this bull's expansion, as QE2 hit in August. Monetary expansion would again be rewarded by the equity market as near-term expansion in GDP seemed certain if the Fed was buying. In each of this year's market phases, various characteristics of portfolio construction and attributes yielded the best results. This of course made it very difficult for portfolio managers to get it right and outperform their benchmarks. By focusing on the long term, providing always a diversified portfolio, and concentrating on growth characteristics of the top and bottom line, Emerald was successfully able to navigate this fast-moving market.

As an example of the variability of various attributes, the best earnings growth stories (the place where Emerald devotes its efforts) exhibited the least performance in December, but the best performance for the year. The clear and distinct winner for the year was beta. For the Russell 2000 Growth Index, the highest percentile beta returned 39%, and the lowest beta stocks were up only 16.8% for the year.

Portfolio Performance

Small capitalization stocks again dominated performance among the indices with the Russell 2000 gaining 16.25%. Within the Russell 2000, growth led value, with the Russell 2000 Growth appreciating 17.11% in the quarter as strength within energy, materials and technology continued to propel the index.

Despite strong market returns, active managers broadly, have continued to struggle. According to a recent report from Steve DeSanctis at Bank of America Merrill Lynch only 43.2% of small capitalization growth managers outperformed for the fourth quarter and only 40.6 percent outperformed for the year as abrupt changes in sentiment regarding economic growth and risk tolerance as discussed above created a challenging environment for managers. That being said, we are pleased to report that Emerald outperformed the index for the quarter, driven by better than index performance within technology, consumer discretionary and producer durables. This was partially offset by underperformance within materials and healthcare. The most notable aspects of quarterly performance are detailed below.

The technology sector was again the largest positive contributor to return during the period driven both by the portfolio's overweight position and stock selection. The outperformance was broad-based with positive variation within the communications, computer software, electronics and semiconductor industries.

As we move in 2011, the technology sector remains the portfolio's largest overweight position. The overweight position is predicated on Emerald's ongoing belief that enterprise spending budgets are being prioritized toward areas such on on-demand software, intelligent networking, wireless networking, storage and cloud computing. Outside of these broader themes, we are also seeing opportunities in niche segments of the market, including industrial lasers. Industrial lasers have experienced rising adoption as an energy efficient and precise tool for cutting, welding, marking, and engraving applications. Demand for industrial lasers has accelerated as capital expenditures by manufacturers have rebounded. Whether it be aftermarket consumables, disruptive new laser technology, or innovative applications of lasers, we believe that the industrial laser market offers one of the market's most compelling growth opportunities over the next decade.

The performance of aerospace, back office support and commercial vehicle and parts industries contributed meaningfully to the outperformance within the producer durables sector during the quarter.

After a challenging third quarter, the consumer discretionary sector contributed positively to return for the quarter driven by stock selection within casinos and gambling, rental and leasing services, restaurants and specialty retail. As we look to 2011, positions within the consumer discretionary sector remain focused on those companies that are positioned to benefit from innovation and market share gains.

Partially offsetting performance within the technology, consumer discretionary and producer durables sectors was disappointing performance in healthcare and materials. Healthcare detracted from performance during the quarter due primarily to disappointing stock selection within biotechnology, medical and dental instruments, and medical equipment. Emerald is currently underweight healthcare, but is becoming more constructive on the sector as we have gained clarity on healthcare reform, and mid-term elections in the United States are behind us. The sector is still facing the headwind of decreased utilization, but this may be moderating as well.

Although performance within the healthcare sector was disappointing, performance within the materials sector was the greatest detractor to return in the quarter. The underperformance was a result of the portfolio's underweight position to the higher-beta industries such as building materials, diversified materials and processing, metal fabrication and metals and minerals. This lack of exposure combined with index-trailing performance in existing positions held in industries such as gold, chemicals and containers all contributed to the disappointing performance relative to the benchmark. While Emerald made adjustments to the positioning within this sector during the quarter, the portfolio remains underweight entering 2011.

Entering 2011 the portfolio is overweight the technology, consumer discretionary and energy sectors and underweight the healthcare, materials, and consumer staples sectors.

Market Outlook

Emerald's overall outlook for 2011 remains positive, based on our outlook for corporate profits and expectations for increased merger and acquisition activity, a carryover from 2010. As cash flow adds to the record cash balances on America's corporate balance sheets, we expect corporations will seek growth by buying market share, customers, and product innovation from their corporate brethren. According to the Wall Street Journal, U.S. corporations raised over $1 trillion in investment grade and high yield bonds that were sold in 2010. This trend continues into 2011, as over $75 billion of new issuance is expected to come to the market in January alone. In addition, companies continue to use cash to transact their buying spree, which means present valuations are attractive.

- *January 10, 2011*