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A Balanced Approach

Two steps forward - one step back

Coming into the New Year, the economy and domestic stock market reflected the tug-of-war between economic improvement and the vestiges of the credit crisis. The first quarter of 2010 fulfilled our expectations of rising interest rates and increased stock market volatility.

World stock markets produced nearly a 10% correction in late January in response to more restrictive monetary policy in China, sovereign debt concerns in Greece, reduced liquidity and quantitative easing by the U.S. Federal Reserve, and increased prospects for more significant financial regulations (Volcker rules). Improving economic trends and prospects of better corporate profits fueled a recovery rally in February and allowed major market averages to make new eighteen month highs in March. We expect this saw tooth pattern (with an upward bias to stock prices) to continue until there is a definitive break in unemployment trends and a tightening of monetary policy by the Fed. The earliest break on either front is not expected until later in 2010.

Healthcare reform and ballooning deficits at the state and federal level have increased the fragility of the nascent recovery. There is no doubt that the financial system and banks are on much sounder footings as capital levels have increased dramatically. The financial cross-currents will require more time to return economic trends to a more normal state.

Recent economic readings portray a generally favorable outlook as consumer spending rose by 2.5% while consumer debt levels fell. Capital goods investment and replenishing inventory will also support economic growth. Residential housing remains a significant source of risk and

potential for the economy. Investors are also concerned with further deterioration and risk that the commercial real estate market currently offers.

Inflationary trends continue to be benign as major inputs (labor, raw materials and capital) are plentiful in the real economy today. The primary inflation concerns relate to extremely high government deficits and the prospect of higher taxes to fund even more government spending. If fiscal discipline is not restored, investors will require higher yields to compensate for the risk. While gold has risen primarily because of these concerns, we do believe the potential inflationary pressures could be more acute in 2011 without improved fiscal discipline.

Fourth quarter corporate earnings reports reflected continued improving profits and strong signs of increasing demand and revenues. The first quarter reports (due out in mid-to-late April) are expected to reflect expansion of margins, profits and revenue. Greatly improved cash flow and financial condition will be reflected in stronger balance sheets, increasing dividends, and share repurchases.

The emerging economies (China, India, Brazil, etc.) and markets have led the world out of recession, followed by North America, while the developed international economies and markets have lagged. The disappointing performance has been centered on the sovereign credit and funding concerns in Europe and how the current situation is testing the immature structure of the European Union (EU). The fiscal imbalances and relative competitive issues are at the heart of the under-performance and are reflected in the decline of the Euro versus the yen and dollar over the last five months.

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Arcataur Large Capitalization Equity Portfolio - This portfolio offers investors a separately managed account consisting of high quality, blue chip stocks. Our strategy focuses on maximizing expected return through constructing diverse portfolios covering most major industry sectors. On average, this portfolio could hold 55 stocks; however, the largest 15 could account for as much as 45% of the portfolio.

Arcataur Investment Grade Fixed Income Portfolio - This portfolio offers investors a separately managed account focusing on Treasuries, Agencies, corporate bonds and municipal bonds, with an average portfolio credit rating of AA or better. Our approach is to actively manage interest rate risk and credit risk while minimizing liquidity risk to generate conservative risk-adjusted total return.

Arcataur Managed Balance Portfolio - This portfolio offers investors a separately managed account which seeks to preserve capital during difficult market periods while allowing growth opportunity in good market conditions. Arcataur has developed a model that assists us in determining the relative attractiveness of stocks versus bonds. When our models and fundamental analysis indicate stocks are more attractive, we will be near our upper end of the range for stocks (75%). Conversely, when bonds are favored, we will be near the lower end of the stated range for stocks (45%).

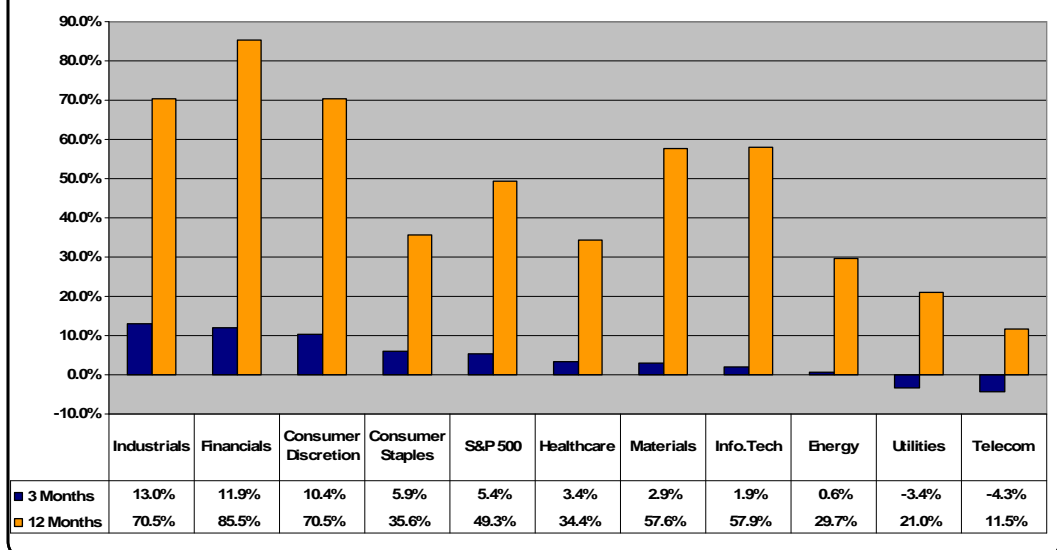
Two steps forward - one step back (continued)

The U.S. economy produced a 5.9% GDP in the 4th quarter of 2009, and the first quarter of 2010 is estimated to range from 2.5 to 3.0%. Upside potential to these estimates relates to increased business spending, inventory replenishing and modest improvements in consumer spending. Commercial construction and sluggish residential housing activity could dampen final results. Federal government spending has supported growth, but austerity measures instituted by the states and the need for private investment to replace public supports must be monitored for economic impact over the coming quarters.

After a brief pullback in January, longer-term interest rates are now approaching pre-credit crisis levels. Stocks followed a similar pattern, but have yet to recover to the levels seen prior to September 2008. Broad equity averages ended the first quarter with another positive quarter, adding to the impressive results from the lows of March 2009. The S&P 500 (total return) was up 5.4% for the quarter and just under 50% for the last twelve months. The smaller capitalization (illustrated by the S&P 600 Small Cap Index) issues were up by 8.6% for the quarter, the NASDAQ Composite was up 5.9%, and the Dow Jones Industrial Average was up 4.7% on a total return basis for the first quarter. Emerging international markets continued to be strong. The emerging market index was up over 2.1% for the quarter and over 77% for the preceding twelve months.

Sector performance reflects the improving outlook for the economy and the financial system during the quarter. The out-performance of the industrial and consumer discretionary sectors relates to more conviction on the sustainability for positive growth. The financial sector continues to benefit from the yield curve and the steps taken to increase capital. Most of the major banks that received government support eighteen months ago are repaying it, with a profit realized by taxpayers. The utility and telecom sector lagged most significantly as investors desire less exposure to these interest sensitive groups in the face of rising interest rates. This could portend more muted performance for the financials in the coming months. The healthcare sector has been in focus as federal reform has been enacted. The investment outlook for this sector is considered in our special section on page four. The commodity sectors (materials and energy) lagged, but showed better performance in late March and early April. The chart below illustrates how all the sectors performed in the quarter and for the trailing twelve months.

Sector Total Return for the Three and Twelve Months Ended March 31, 2009

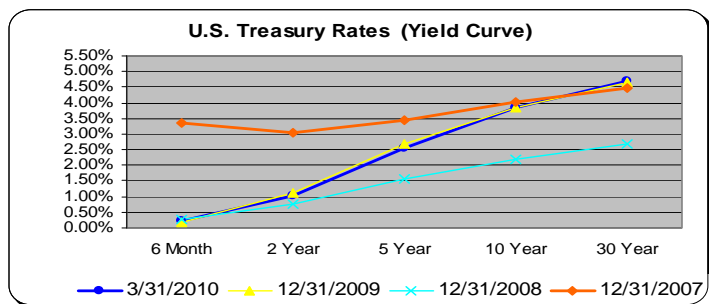


Source: Baseline

Hunt for yield

Money market rates continue to be near zero as the Federal Reserve kept the federal funds target rate between zero and 0.25% to stimulate the economy. Recent Fed meetings did not convey any sense of urgency to remove policy stimulus via higher interest rates. They again reiterated the verbiage of keeping rates “exceptionally low” for an “extended period” of time. Fixed income investors are watching closely for any change in this language as a sign the Fed will start to raise interest rates. Employment statistics are being closely watched for signs of economic strength and possible clearance for the Fed to move.

The Fed and Treasury did take several actions to drain excess liquidity in the financial system including: A.) the Fed raised the discount rate (the interest rate the Fed charges banks to borrow short-term funds); B.) the Treasury raised the amount of the Supplementary Financing Program (SFP) auctions from \$5B to \$200B. The Treasury will sell short-term treasury bills to banks and reabsorb excess reserves that are sitting idle now (not being lent); and C.) the Fed increased the number of counter-parties used for reverse repurchase agreements to include the 18 primary dealers and domestic money market funds. The Fed would sell assets on its balance sheet to these counterparties for agreed upon periods of time, again draining excess reserves from the system. These actions have been well-scripted and have not caused any disruption in the fixed income market.

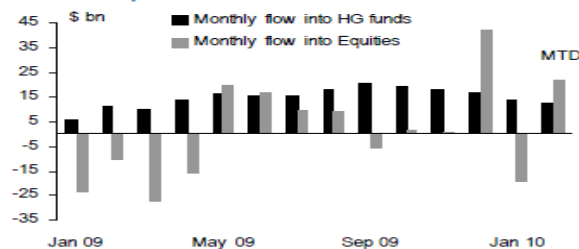


Source: Baseline

Treasury yields over the course of the quarter were almost unchanged. In early February, bond prices rose (yields fell) on concerns of sovereign debt default (Greece) and expectations for slower economic growth which drove investors to seek the safety of Treasury bonds. That sentiment changed by the end of the quarter as economic trends appeared stronger and a plan to stabilize Greece emerged. Up until that point, investors eagerly participated in Treasury auctions; however, the last three auctions in March drew weak demand and forced higher yields (lower prices) than expected. The yield curve remained steep (longer maturity yields higher than shorter maturing yields) during the quarter as economic recovery is priced in by investors.

Cash continues to flow into bond mutual funds as investors search for alternatives to near zero returns on money market funds. According to the Wall Street Journal, bond funds took in \$90 billion in the quarter and U.S. stock funds saw inflows of \$3 billion.

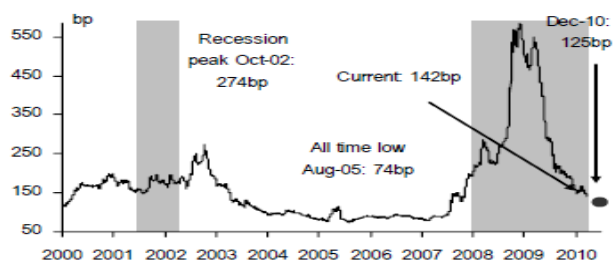
Exhibit 4: Monthly inflows to High Grade continue but at a slower pace



Source: J.P. Morgan

Demand for corporate bonds (providing higher yield) remains high due to improving credit fundamentals and reduced supply, causing spreads over similar maturity Treasuries to tighten (narrow). At the peak of the credit crisis, investment grade bonds traded at a spread of 510 basis points (5.1%) over Treasuries. That spread has tightened to about 150 basis points (1.5%), which is the narrowest since November 2007. Corporate balance sheets have improved as reduced costs and spending have increased profit margins and cash flow. Corporate treasurers are further strengthening their balance sheets by calling in shorter maturity debt and replacing it with longer maturity debt which carries lower interest costs.

Exhibit 1: High Grade bond spreads have continued to tighten...



Source: J.P. Morgan

Dealers' corporate bond inventories are not plentiful and the pricing is not as attractive as it was in 2009. It has been difficult to find an adequate supply of individual issues that meet our criteria for price, quality and yield, so purchases have slowed recently, but the portfolios remain over-weighted in corporate bonds versus our internal objectives. The biggest risk to all bonds, including corporate bonds, is an aggressive tightening program by the Fed.

The duration of our fixed income portfolios continues to be short as we expect higher interest rates as the economy normalizes. We have selectively been buying investment grade corporate bonds and callable agency debt. The investment grade portion of our portfolio remains diversified across market sectors and we avoid concentrations of exposure in any single company. Recently we have increased exposure to inflation protected treasuries (TIPS) that carry attractive current yields but reduce the risk associated with rising yields. Arcataur continues to focus on high quality bonds and the overall quality rating of the fixed income portfolio is high single A.

Second Quarter 2010 Investment Outlook

The predominant question last year was “how much lower can the market and economy fall?” Twelve months later, the focus is now “has the market gone too far too fast?” The short answer is no. There is plenty of upside opportunity for growth and capital appreciation, especially in the aftermath of the severe global credit crisis. Corporate profits, cash flow and balance sheets will support rising stock prices over time. Consumer balance sheets are improving with rising savings rates and reduced leverage. The key factors for the foreseeable future are employment trends and the magnitude and speed of interest rate increases.

Increasing employment will improve economic growth and strengthen consumers’ financial prospects. Based upon current trends we don’t anticipate a significant improvement in hiring trends until late 2010 or early 2011. With the uncertainty of increased regulation, taxes, financing costs and sustainability of growth, most companies have little incentive currently to hire with the availability of temporary labor.

With that assumption, relatively lower interest rates allow for more time to repair the damage of excessive leverage. If interest rates rise gradually, it allows over-levered parties (consumers, commercial real estate investors, state and federal governments) the opportunity to deal with the excesses. The more dire forecasts focus on a sudden and dramatic rise in interest rates in response to massive government deficits if fiscal discipline cannot be restored. We do not subscribe to this outlook currently, but understand the potential if the probability of this scenario increases.

Current stock market valuation is fairly normal, even after the significant rise in equity prices over the last twelve months. Given the prospect of improving corporate profits and benign input cost inflation, stock prices can be considered attractive on an historical basis (a forward price earnings ratio of 13 to 16 times). Typically this would imply moderate upside potential for stock market performance, but the presence of large fiscal imbalances and unsustainable monetary policy provides for headwinds for the foreseeable future. These cross-currents will allow for significant trading opportunities similar to what we saw during the first quarter. We would

anticipate over time for stocks to realize normal corrections (5 to 10%) with an overall upward bias assuming a gradual rise in employment trends and interest rates.

Government-led support of major banks and the auto industry has been a success, while AIG, Fannie Mae and Freddie Mac have been less effective. Healthcare reform has been enacted, but time will tell how effective it can be. Financial regulation reform will be next, but investors will be keenly focused on improving fiscal discipline. Elections this fall could be a judgment on all of this, but most likely will be decided based upon the outlook for jobs and the economy.

For our large capitalization direct portfolios, we have increased exposure to more economically sensitive sectors which will out-perform as the expansion improves.

Our high quality fixed income portfolio has offered stability and balance over the last 18 months. The current environment offers more challenges to find value and yield; as a result, a defensive and liquid posture is being maintained.

Our Managed Balance portfolios are maintaining an above average exposure to stocks, as valuations and relative attractiveness favor equities over fixed income investments.

Initial thoughts on investment implications of healthcare reform

After seemingly endless debate, the Health Care and Education Affordability Act of 2010 passed into law March 21, 2010. Although the bill is massive (well over 2,000 pages) and deals with an industry that accounts for nearly 20% of our GDP, the immediate impacts are surprisingly modest due to a gradual ramp in implementation. Full implementation will not happen until 2015 for many of the key provisions. Given the intense controversy this bill engendered and that there is one Presidential election cycle and two mid-term election cycles prior to full implementation, it is a distinct possibility that there could be major changes in this bill before it is fully in force. This political fact along with the gradual ramp up in implementation and the relief that a more onerous (higher cost and mandatory regulation) version of the reform did not pass explains the muted reaction to passage by both the overall market and the healthcare sector. Looking out two to three years we believe the legislation will exert only a mild impact on healthcare stocks, probably less of an impact than traditional factors like success or failure of new products, patent expirations, safety/efficacy issues, the aging of the baby boomers, etc. The short-term consensus, which we share, is that most healthcare sectors will enjoy a modest net benefit as previously uninsured citizens, maybe as many as 30 million, become eligible for health insurance coverage and, subsequently, consume more medical products and services. Of course, there is a price to pay for this windfall through large annual payments and product taxes by pharmaceutical and device companies, floors on medical loss ratios (restricting pricing flexibility) for the insurance companies, and major changes in insurance firms’ traditional underwriting approach to name just a few, but, on balance, the incremental profit generated by the additional customers will modestly exceed these costs. With almost all government actions there are unintended consequences, and quite often these unexpected results can be substantial. Given the size of this bill, the vagueness of many of its provisions, and the complexity of healthcare itself, it is a good bet that this bill will beget major unintended consequences, which will be a focus for investors, consumers, and providers of healthcare over time.



Arcataur Composite Investment Performance for the Three Months, Twelve Months and Three Years Ended March 31, 2010

Arcataur Composite Portfolio	Total Return 3/31/2010		
	3 Months	12 Months	3 Years Ann.
Large Cap Equity	4.53%	46.56%	-4.55%
Benchmarks			
Lipper Large Cap Core	4.90%	48.50%	-4.21%
S&P 500	5.39%	49.77%	-4.17%
S&P 100	4.60%	45.90%	-3.41%

Arcataur Composite Portfolio	Total Return 3/31/2010		
	3 Months	12 Months	3 Years Ann.
Fixed Income	1.53%	8.74%	5.43%
Benchmarks			
Citi BIG 1-5 (T/G/C)	1.20%	5.26%	5.62%
Citi BIG (T/G/C)	1.55%	7.31%	6.01%
Lipper Bond MF Avg.	2.40%	19.60%	4.60%

Arcataur Composite Portfolio	Total Return 3/31/2010		
	3 Months	12 Months	3 Years Ann.
Small Cap Equity	8.74%	64.42%	-3.71%
International Equity	1.47%	57.46%	-6.74%
Total Equity*	5.12%	52.59%	-4.67%
Benchmarks			
Lipper Small Cap Core	8.00%	63.10%	-4.50%
S&P 600	8.61%	64.00%	-3.16%
EAFE	0.22%	49.99%	-9.64%
S&P 500	5.39%	49.77%	-4.17%

Arcataur Composite Portfolio	Total Return 3/31/2010		
	3 Months	12 Months	3 Years Ann.
Managed Balance	3.96%	35.22%	-1.26%
Benchmark			
Lipper Balanced	3.70%	35.60%	-0.82%

*Total Equity is not an actual composite portfolio; rather, Total Equity represents a weighted average return of the Large Cap, Small Cap and International composites, and is only shown as an indication of potential overall equity performance. Total Equity does not represent any actual portfolio because it is made up of a weighted average return of all equity classes.

Appendix: Disclosure Information Regarding Composite Performance

General

Arcataur Capital Management LLC is a registered/licensed investment adviser. Arcataur has prepared this report. The information in this report has been developed internally and/or obtained from sources which Arcataur believes are reliable; however, Arcataur does not guarantee the accuracy, adequacy or completeness of such information nor do we guarantee the appropriateness of any strategy referred to for any particular investor. Index information has been taken from public sources. Past performance is not indicative of future results, as investment returns will vary from time to time depending upon market conditions and the composition of the composite portfolio. Returns for individual investors will vary based on factors such as the account type, market value, cash flows and fees.

Calculation Methodology

Arcataur has generally prepared these composites in substantial compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPStm) in the calculation and presentation of investment performance composites, with one notable exception relating to the treatment of cash: cash is not included in the performance calculations for the Arcataur Large Capitalization Equity Portfolio Composite or the Arcataur Investment Grade Fixed Income Composite; Arcataur also does not allocate cash in the Arcataur Managed Balance Portfolio Composite to the equity or fixed income components when calculating performance for those components. Cash is, however, included in the overall performance calculation for the Arcataur Managed Balance Portfolio Composite. AIMR has not been involved in the preparation or review of this report. Arcataur is not claiming AIMR compliance.

The composites reflect dollar-weighted returns of individual accounts. Arcataur uses the AIMR recommended time-weighted internal rate of return formula (i.e., returns that include reinvested dividends and other income) to calculate performance for the accounts included in the composite. Individual account returns are calculated on a time-weighted basis, linked monthly, and include reinvestment of dividends and other such earnings. Total return (return) is defined as the percentage change in market value (including interest and dividend income) adjusted for any client-directed cash flows. A time-weighted, monthly-linked method is used to calculate composite calendar quarter returns. Quarterly returns, rounded to two decimal places, are geometrically-linked to calculate annual, cumulative and annualized returns. No leverage or derivatives have been used. Accounts are added to the composites when at least 70% of the account's value is invested in accordance with the client's investment plan and in accordance with the investment style chosen for the account. Terminated accounts are maintained in composites through the last full month assets are managed. Arcataur uses the accrual basis of accounting for the presentation of performance results, with the exception of the treatment of dividends - dividends are recorded when received. Portfolio return calculations and portfolio valuations are based on trade date settlement. (cont.)



Appendix: Disclosure Information Regarding Composite Performance (cont.)

Composites

The Arcataur Large Capitalization Equity Composite consists of portions of all client accounts invested in accordance with the Arcataur Large Capitalization Equity Portfolio strategy (including ETF's).

The Arcataur Small Capitalization Composite consists of portions of all client accounts invested in small capitalization equity securities (including ETF's).

The Arcataur International Composite consists of portions of all client accounts invested in international securities (including ETF's).

The Arcataur Investment Grade Fixed Income Composite consists portions of all client accounts invested in accordance with the Arcataur Investment Grade Fixed Income strategy.

The Arcataur Managed Balance Composite consists of portions of all client accounts invested in accordance with the Arcataur Managed Balance strategy.

Mutual fund holdings are not included in composite results. Exchange traded funds are included in composite results. Mutual fund holdings typically are "unmanaged assets" and, therefore, are not included in composite results. Exchange traded funds are designated as "managed assets" and, therefore, are included in the composite results.

Fees

Performance figures that are "net" of fees take into account investment advisory fees and any brokerage fees or commissions that have been deducted from the account. Performance figures that are "gross" of fees do not take into account investment advisory fees or transaction costs. For "gross" performance figures, actual returns will be reduced by expenses that may include management fees and transaction costs. A client's return is reduced by investment advisory fees and commissions, and any other expenses (such as custodial fees) that it incurs relative to its investment advisory account. Performance figures do not take into account federal or state income taxes. Arcataur's investment management fee schedule is included in Part II of the Form ADV. The Arcataur Large Cap, the Arcataur Small Cap, the Arcataur International, the Arcataur Investment Grade Fixed Income and the Arcataur Managed composites are net of fees. The S&P 500® Index, S&P® 100 Index, S&P 600® Index, the EAFE® index, the Citigroup Broad Investment Grade Index (T/G/C), and the Citigroup Broad Investment Grade Index (T/G/C)(1-5 Years) are gross of fees; the Lipper Large Cap Core, Small Cap Core, Balanced Fund and Bond Fund Averages are net of fees.

Indices and Benchmark Funds

The Indices and Benchmark Funds are referred to for comparative purposes only and are not necessarily intended to parallel the risk or investment approach of the accounts included in the composites. Arcataur believes that the Indices and Benchmark Funds selected for comparative purposes are appropriate measures given the investment approach. However, the investment portfolios underlying the indices are different from the investment portfolios managed by Arcataur. The Indices and Benchmark Funds shown are unmanaged, and investors may not invest directly in them. The Indices and Benchmark Funds are considered to be generally representative, in terms of risk and exposure, of the various components as follows:

Arcataur Large Capitalization Equity Portfolio - the S&P 500® Index, the S&P 100® Index and Lipper Large-Cap Core Average

Arcataur Investment Grade Fixed Income Portfolio - the Citigroup Broad Investment Grade Index (T/G/C) and (1-5 Years) and the Lipper Bond Mutual Fund Average

Arcataur Managed Balance Portfolio - Lipper Balanced Fund Average

If a client's portfolio contains small cap exposure, the small cap performance is measured against the S&P 600® Index and Lipper Small Cap Core Average. If a client's portfolio contains international exposure, the performance is measured against the EAFE index.

With the exception of the Lipper Balanced Fund Average, the Lipper Large Cap Core Average, the Lipper Bond Mutual Fund Average and the Lipper Small Cap Core Average, indices and benchmark funds shown reflect the reinvestment of dividends and other earnings, but do not include transaction costs, management fees or other expenses of investing. For further information concerning the Index and Fund Benchmarks, ask to see Arcataur's Benchmark Descriptions.

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