Volume 2022 Issue 2

Second Quarter Review
June 2022

Arcataur Capital Management LLC
A Registered Investment Advisor

High Quality Investment Management
For Individuals and Institutions

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Risks Intensify with Stubborn Inflation & Economic Weakness

Over the last nine months, global monetary authorities, including the U.S. Federal Reserve, have shifted the outlook on inflation from their initial stance of temporary and transitory, to sticky, and more recently, to structural and stubborn. The May consumer price index (CPI) reported on June 3rd of 8.6% was higher than expected and the highest reading since December 1982. This pushed forecasts of peak inflation further out into the future. In response, interest rates have climbed significantly which pushed both bond and stock prices down, creating the first significant tandem bear market for bonds and stocks since 1994. The Fed reacted to the higher-than-expected CPI report with a more aggressive move of 0.75% increase in the Federal Funds interest rate at their June 15th meeting.

Higher inflation is incrementally putting pressure on economic growth. Food and energy prices are the most noticeable and impactful to consumers, but inflation effects are widespread. The Fed's more aggressive moves to calm inflation increases the risk of an economic slowdown and perhaps even a recession in the next 12 to 18 months. While the significant rise in energy prices can be partly attributed to the Russian invasion of Ukraine, broader supply-side disruptions are a significant factor that will not be resolved by higher interest rates. As an example, the lack of normal semiconductor supplies continue to disrupt the technology, automotive, and broader manufacturing industries with ongoing shortages.

China's approach to dealing with new Covid outbreaks (their Zero Covid strategy) with lockdowns has hamstrung supply chains for materials and finished products. China's support for Russia's territorial ambitions has also raised geopolitical concerns over a possible Chinese invasion of Taiwan, a country with a significant and essential semiconductor manufacturing market share.

The massive amount of both fiscal and monetary stimulus in the U.S. during the early stages of the Covid outbreak and the rollout of vaccines minimized the economic damage during the shutdowns. However, while boosting demand to prevent a longer economic downturn, it also pulled demand forward at a time when supply chains were constrained. Record low unemployment, rising wages, and historical low financing costs fueled a significant boom in housing prices but without the needed supply response.

Stimulus payments assisted the most needy, but ballooned savings rates to historically high levels. After the most dire fears of Covid receded, Americans spent liberally to improve their living spaces. More recently, travel, services, and experiences have become the consumer's priority, as earlier Covid restrictions created significant pent-up demand.

Today, consumer savings rates have normalized to pre-Covid levels. Some retailers have recently reported disappointing sales and excess inventories of items that were in short-supply a year ago. The housing market is showing early signs of cooling down with significantly higher mortgage interest rates that have essentially doubled since last summer.

While the volatile first quarter ended with the S&P 500 being down less than 5%, the persistent inflation trends in the second quarter dragged stocks into bear market territory with a decline greater than 20%. The Fed's more aggressive response also created an inversion (shorter-term bond yields higher than longer-term bonds) in the bond market in late June. Investors are keeping a close eye on when we will see a meaningful peak in inflation and if it is accompanied by a material economic deceleration.

Oil and natural gas prices shot up to a 14-year high and triggered further "higher for longer" inflation concerns among consumers, businesses, and investors. Global oil prices traded above $125 per barrel in early March, and have stayed within a trading range between $95 and $120 since then. The sanctions imposed on Russia have been somewhat circumvented by the willingness of China, India, and other countries to buy Russian oil.

With continental Europe more dependent on Russian oil and natural gas, the potential for economic deceleration increased in Europe and Asia. North America's economic outlook was less affected given its self-sufficiency in resources of natural gas and significantly lower demand for Russian oil. The lack of an intermediate transition plan relating to environmental considerations by the Biden Administration has curtailed increased production for domestic consumption.

North American and most developed countries appear to be in the endemic phase of the COVID-19 virus. This should provide continued normalization of human and economic activities. The availability of reformulated vaccine boosters and anti-viral treatments should assist in minimizing the risk of the virus in the future.

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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 65 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 A 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%).

Risks Intensify with Stubborn Inflation & Economic Weakness (cont.)

The Chinese economy and stock market are showing signs of reopening and recovering gradually by instituting stimulus to increase consumption and business activity. A sustainable recovery can potentially improve supply chain dislocations globally and demand for goods and services from the second largest economy in the world, though geopolitical differences with the U.S. and it's allies remain a significant complicating factor.

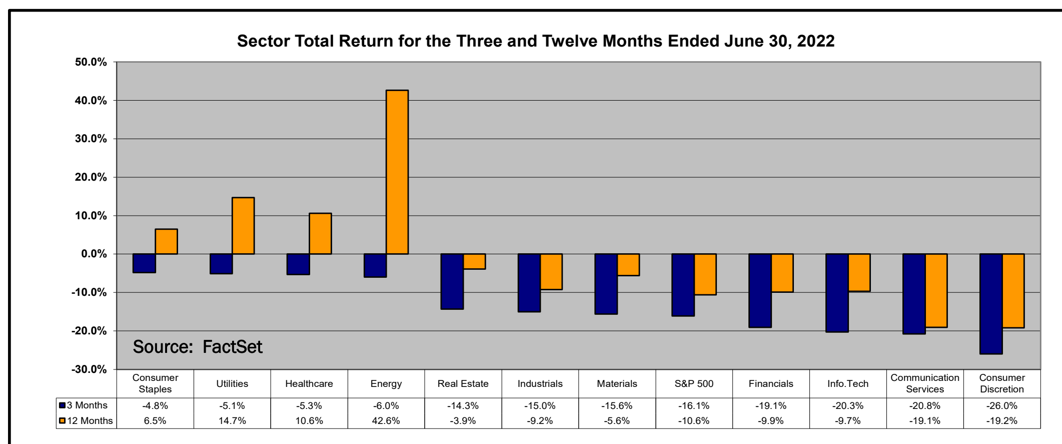
Employment trends and wage growth are likely to be primary determinants of the economic trajectory in the coming years. Employment gains have decelerated somewhat, but remain above historical levels currently with near record low unemployment of 3.6%. Annualized wage increases of 5.1% reflect a solid job market, as labor participation continues to be impacted by the surge in self-employment, changing demographics, increasing retirements, fewer women in the workforce, and declines in part-time workers. While this benefits workers in the short-run, if the cost of living continues to rise faster than wages, it becomes a net negative overall for consumers, especially for the most vulnerable at the lower to middle end of the income spectrum.

Equity valuations improved during the quarter as the declines in stock prices were offset by stable earnings expectations. Corporate profits appear to be at a higher risk to be revised lower in the coming quarters which could undermine potential valuation support. The strong U.S. dollar is expected to have a negative impact for multi-national companies. The upcoming second quarter earnings reports are expected to be challenging due to higher inflation and the risk of more conservative guidance from management. Small and mid-capitalization companies are currently trading at more attractive valuations than larger capitalization companies, however smaller companies can be more economically sensitive too. Changes in demand, earnings growth, and interest rates expectations will be significant factors for investors in the upcoming quarters.

Despite the large increase in the Federal Funds interest rate at the June FMOC meeting, the Fed did not alter its previously announced details for QT (Quantitative Tightening or reducing bonds held on its balance sheet), which could impact longer term interest rates and the shape of the yield curve. Removing the most significant buyer of Treasury and mortgage-backed bonds over 10 of the last 14 years may push longer interest rates higher. However, with the recent inversion of the yield curve, rising interest rates may be more of a near term problem than longer term. The Fed would like to reduce/normalize its balance sheet in an orderly fashion, however the lack of historical precedence makes this an important process to monitor. A significant reduction in the Fed's balance sheet would allow interest rates to be formed by the market, which would be a positive transition in our opinion.

For the quarter, the S&P 500 (total return) was down 16.1%, and the Dow Jones Industrial Average fell by 10.8%. The technology-heavy NASDAQ Composite declined by 23.5% in the quarter. The S&P 600 Small Cap Index fell by 14.1% and the S&P 400 Mid-Cap was down 15.4% in the second quarter. Developed international markets fell, down 14.5% and emerging markets were off, down 10.4% for the quarter.

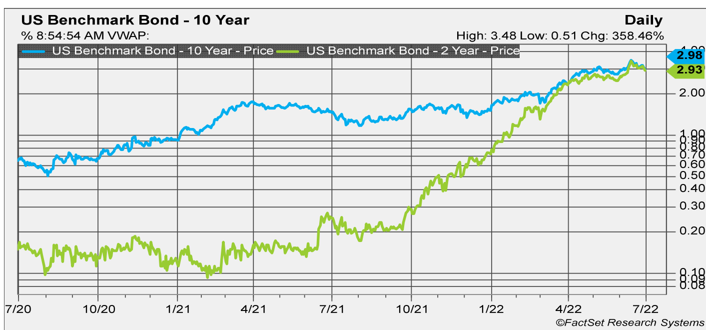
Sector performance for the quarter was impacted by inflation which pushed stock prices lower by more than 8% for the month of June after the hotter inflation report in early June. Defensive areas (utilities, staples and healthcare) and the energy sector outperformed the broader market in the quarter and for the last twelve months. Those four sectors produced positive returns over the last year, with energy continuing to provide significant outperformance, but represent less than 30% of the S&P 500. Technology and Communication Services sectors represents more than 35% of the S&P 500 and those areas lagged significantly. The chart below illustrates how all the sectors performed in the quarter and for the trailing twelve months.



	Consumer Staples	Utilities	Healthcare	Energy	Real Estate	Industrials	Materials	S&P 500	Financials	Info.Tech	Communication Services	Consumer Discretion
3 Months	-4.8%	-5.1%	-5.3%	-6.0%	-14.3%	-15.0%	-15.6%	-16.1%	-19.1%	-20.3%	-20.8%	-26.0%
12 Months	6.5%	14.7%	10.6%	42.6%	-3.9%	-9.2%	-5.6%	-10.6%	-9.9%	-9.7%	-19.1%	-19.2%

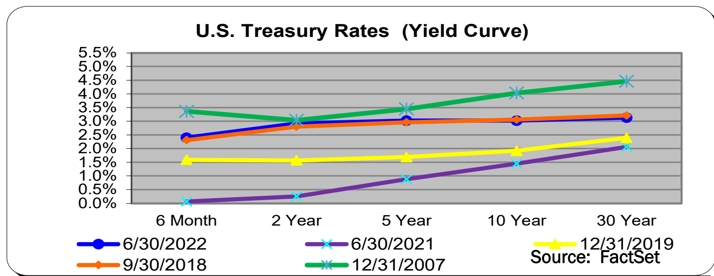
Inflation Still Here… Will Higher Interest Rates Slow It Down??

The bond market in the second quarter of 2022 was arguably more volatile than the first quarter. With rising inflation, the end of quantitative easing, and fears of a recession mounting, interest rates skyrocketed in the quarter to levels not seen since 2018. Shorter maturing bonds yields (1 to 4 years) had the steepest increases, which briefly produced an inverted yield curve (shorter term yields higher than longer maturities). Longer-dated maturing bond yields rose, but not as much as the shorter end of the curve. In the second quarter, the 2-year Treasury bond rose from 2.29% on April 1st, to 2.96% at quarter-end, while the 10-year Treasury bond rose from 2.32% to 2.95%. For reference, the year began with the 2-year and 10-year Treasury bonds yielding 0.73% and 1.51% respectively. When interest rates and bond yields rise, bond prices fall, however if held to maturity, par value or principal is returned in entirety. The second quarter's significant rise in yields led to short term unrealized losses for client's fixed income portfolios, but also provided opportunity to achieve higher yields on new bond investments. As a reminder, our "Bond Basics" piece within our investor educational series provides more details and examples how rising or falling interest rates impact interim market value of bonds. We have been active in the quarter putting idle cash and matured bond proceeds to work for clients with yields on a fixed income investments at the highest levels in the last three plus years.

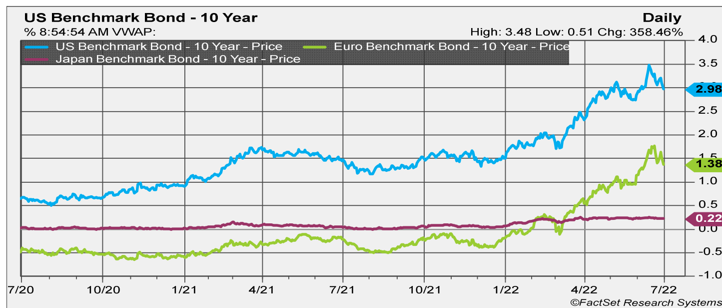


The Federal Reserve and stubborn inflation data have certainly impacted the bond market. At its June 15th meeting, the Federal Open Market Committee (FOMC), led by Fed Chairman Jerome Powell, hiked the Federal Funds Rate 0.75%, the largest single Fed rate increase since 1994. This was done to help combat inflation rates (May CPI of 8.6%) that have not been seen for decades. The Fed noted that another 0.50-0.75% increase in interest rates could come again at its July meeting. In addition, the Fed reiterated their desire to end quantitative easing by continuing to reduce bonds held on its balance sheet. While the prospects of a recession has stoked investor's fears, the Fed delivered their summary of economic projections, which are the Fed's predictions for various economic indicators in the future. The Fed projects unemployment to rise to 4.1% by 2024 and GDP growth of less than 2% for the next two years, but are not currently forecasting a recession. They are aiming for a "soft landing" (a gradual slowing of economic activity, but avoiding two consecutive quarters of negative growth). If, however, inflation remains above the target it may require additional interest rate hikes that could be the catalyst which triggers a recession. The recent volatility and weakness in the financial markets indicates a higher risk of a global recession. The next Fed moves will be the major focus for investors going into the second half of 2022.

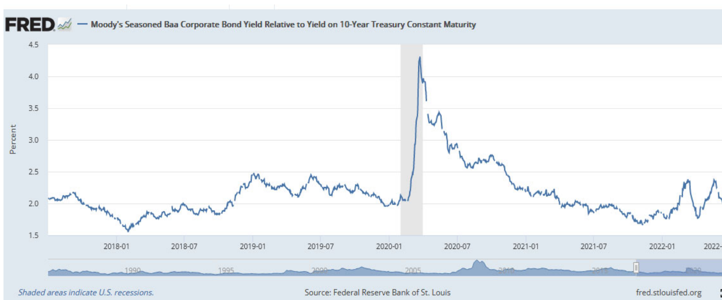
The following chart highlights historical Treasury yield curves (bonds yields for the spectrum of maturities). The blue line depicts the current yields. The yellow and purple lines show how depressed the yields were during 2019 and 2021 which offered poor investment opportunities for new bond investments. The orange line, essentially the same as the blue line is late 2018 and it was the last time the Fed was raising interest rates to the degree it drove reasonable opportunities for new fixed income investments. The green line is from 2007, just before the great recession and the Fed aggressively pursuing quantitative easing (QE).



While the U.S. is realizing higher interest rates, other countries are finally catching up after years of negative nominal interest rates around the globe. The chart below depicts how much the U.S. and EU 10-year bond yields have risen since the beginning of the year. For example, the EU 10-year bond began the year below 0% and now is above 1.4%. Much of the rest of the world is in a similar situation as the U.S. with higher inflation rates that have negatively affected economies globally.



Credit spreads (the incremental yield received to compensate for default risk) have also risen materially in 2022 after being at or very near to historic lows in 2020 & 2021. The chart below, illustrates that credit spreads have doubled from nearly 1% to 2% this year. This rise in credit spreads and the rise in Treasury yields have made corporate bond investments much more attractive versus 2020 and 2021. Investors are beginning to factor in credit risk and the fact that the Fed may not currently have the flexibility to provide liquidity in periods of stress, such as March of 2020 and September 2008. With the economy slowing, spreads are likely to stay at these levels or move higher until there is some signs that the economy is stabilizing.



With the Fed focusing on combating ultra-high inflation, investors should expect continued volatility until inflation starts cooling off. With significant rise in interest rates, our team became more active in increasing clients bond exposure. U.S. Treasury bonds have provided reasonable yields for new investment for the first time in the last four years. Taking advantage of higher interest rates is ideal for clients who desire safety, diversification, and a steady income stream, which can be beneficial in periods of high equity volatility like we have experienced this year. While we have been more active in the bond market this quarter, we remain prudent and patient in our investment decision making. The overall quality rating of the fixed income portfolio is single A, the aggregate weighted average duration is 4.5 years, and liquidity remains sufficient to take advantage of opportunities as they arise.

Third Quarter 2022 Investment Outlook

With the financial market decline, investor sentiment sunk lower in June in response to the higher inflation data and a more aggressive move by the Fed to address it. The bond and stock market moved into bear market territory and the risk of recession has risen from a very low probability to nearly a 50/50 proposition. The declines in asset values appear to reflect a modest or average recession based upon historical data.

While there is a high likelihood of a 'technical' recession (which is two consecutive quarters of negative GDP), which may start as soon as the second quarter, a closer look at the data minimizes the potential impact in this case. U.S. GDP for the first quarter was -1.4%, comprised of +2.7% growth, but offset by a surge in imports, as wholesalers and retailers rebuilt inventory. Economists expect this cannot persist much longer, and imports in due course will drop outright, and net trade will boost GDP growth forward.

Historically, these dramatic declines in market sentiment provide investment opportunities as risks are reflected in asset prices and future data starts to improve. Currently two significant determinates of market levels, inflation and corporate profit trends, need to be monitored closely to see if the current economic and market clouds pass towards sunnier skies or if a more significant storm is on the horizon.

Most expected the May CPI report to be lower than the April reading, signaling a peak in inflation rates with less onerous price increases going forward. The incremental rise in May CPI, in our opinion, delayed this process and spooked the markets, but didn't eliminate the chance of a peak occurring in the coming months. An eventual peaking in inflation could go a long way in soothing consumer and investor's anxiety.

Historically, 8 of the last 17 spikes in inflation have led to a recession in the following 12 months. In 6 of those 8 time periods, the recession started before or near the inflation peak. In regards to the other 9, there was no recession within 3.5 years after the apex in inflation. There have been only 5 periods since 1940 where inflation spiked greater than 8%. In all five cases, inflation fell by more than 50% in the following 12 months after the peak.

Annual stock market returns have averaged +13.2% after inflation peaks. In those cases where no recession followed, stocks were up 17.2%, but those periods with a recession, stocks still rose by 9%. While the current period is obscured by the extraordinary monetary policy of the last 14 years, the historical data indicates that investors and consumer's outlook tends to improve with a normalization of inflation. Recent trends in commodities, such as lumber and copper, support the potential of a topping in inflation rates.

Corporate profits have risen dramatically since the summer 2020, as the economy recovered from the covid related shutdown and the significant amount of fiscal stimulus by the Federal government. Profits were expected to increase 8% to 10%, albeit at a slower trajectory in 2022. While the first quarter reports in April were consistent with that forecast, the continued move upward in inflation and the Fed's tightening process are raising concerns for lower earnings.

The rise in the U.S. dollar can significantly impact multinational companies earnings, along with a contraction in overall economic activity relating to a recession. The duration and depth of a recession will have a direct impact on earnings and how to view current valuations for stock prices. We believe equity prices reflect a moderate to average recession today, however stocks will react to upcoming earnings reports for the second quarter later in July and for any guidance management may provide for the rest of the year and into 2023. The valuation decline from 21 price-earnings ratio to 16 times on forward S&P 500 earnings would imply the market is fair to slightly undervalued versus history. However, meaningful downward changes to the earnings outlook could quickly change the valuation proposition.

Geopolitical issues relating to the Russian/Ukrainian conflict, China, Iran, and the entire Middle East are potential sources of risk and opportunity. This stress could soften over time, but it could be the case that we have arrived at the crossroads with a future characterized by a structural increase in geopolitical risks, with Russia's invasion representing the tip of the iceberg.

The fortunes created and lost in the crypto-currencies have been staggering. The concept of digital currency has merit, however the recent declines smacks of leverage induced selling that may have contributed to broader market volatility.

The mid-term elections could be an additional challenge for investors, as volatility typically increases in late summer through the November election. Financial markets tend to react favorably to a divided government, as it minimizes the probability of destabilizing or significant legislation. Having more clarity on inflation, monetary policy, and geopolitics over the next 3 to 6 months could provide more direction in terms of economic growth, as well as risks and opportunities for financial markets.

A steady rise in interest rates would be a sign of strength and a benefit for savers, with yields not seen in a few years. Bond yields have moved higher this year, as investors demand higher compensation for inflation and as the Fed drains liquidity and the extraordinary support it provided to the economy. The best outcome would be a gradual rise in interest rates, so the economy can digest the increases and continue to grow. The recent flattening of the yield curve reflects that investors view the Fed's moves will be effective in combatting inflation.

For our clients, total equity exposure remains slightly above average within targeted ranges. Rising interest rates over the last 9 months allowed for new investment opportunities, especially in the bond market with more attractive valuations and higher yields. Incremental new investments in stocks and repositioning towards small and mid-capitalization equities was a focus as opportunities arose.

Historical Bear Market Data Helps Keep Current Challenges in Perspective

Investors are enduring the first meaningful bear market since the 2008-09 Great Financial Crisis, acknowledging the sharp selloffs in early 2020 and late 2018 created 20% declines but recovered swiftly with a reversal in monetary policy. The Federal Reserve's swift and massive maneuvers to support the economy and stabilize financial markets during COVID has, to a degree, sowed the seeds for our current inflationary predicament. What makes the current market particularly difficult for investors with diversified portfolios is the tandem decline of both bonds and stocks. Looking forward, history can provide some perspective for investors relating to bear markets and recessions, which are a normal part of our economic system. Since the beginning of the bond bull market in1982, the U.S. equity markets have endured 10 bear markets. The average decline of those bear markets has been 32% and the average duration from peak to trough has been approximately 12 months. The typical time for equity indices to recover back to peak prices in these 10 bear markets has been 21 months from the trough. These averages obviously include significant bear markets (such as 2009 and 2002) that were far worse than average, but they do provide useful perspective. Based upon historical standard it is reasonable to say currently investors may have endured the majority of negative returns in this bear market and about half in terms of time. The current economic and sentiment backdrop also offers mitigating factors to a more protracted bear market. First, corporate and consumer balance sheets are both in exceptionally strong positions. Second, more people are working, and labor markets are tight. Third, even with some expected downward revisions in corporate profit estimates, valuations are starting to become supportive of stock prices. Fourth, investor's sentiment is extremely negative and fund managers are maintaining above average cash positions and below average stock positions. Fifth, although much of the speculative excesses (Crypto-currency, SPACs, Meme stocks, NFTs, Stable coins, and others) declined significantly, to date credit markets have been orderly with limited evidence of systemic credit market risks. Investment grade and high yield bonds have begun to price in a more normal level of default risk. U.S. banks remain in extremely strong financial condition. The primary difference currently, that history does not provide much guidance for, is the reversal of the extraordinary monetary policy employed globally over the last 14 years. We believe more data in the coming quarters will help with this analysis. At the psychological level, voluminous academic research has documented that the pain that investors feel from losses dwarfs the pleasure they derive from gains. Bear markets, therefore, incrementally impact investor confidence. In reality, markets go up most of the time, with positive annual returns 73% of the time. Bull markets' duration and magnitude are significantly higher than the duration and negative returns of bear markets. Over the last 91 calendar years, the S&P 500 produced only 35 years with an annual negative return and only 6 of those years had a negative 20% or worse total return. Attempts in timing the market with wholesale reductions in stock exposure has historically reduced returns by nearly half if not invested in the 10 best days during a decade. Maintaining a well-diversified stock portfolio appropriate for your risk tolerance is an essential tool in capturing the eventual capital appreciation achievable over longer periods of time. Current conditions notwithstanding, we are confident positive returns will continue to dominate in future years.

Arcataur Composite Investment Performance for the 3 Months, 12 Months, 3 Years, 5 Years & 10 Years Ended June 30, 2022

Arcataur Composite Portfolio	Total Return 3 months	12 months	3 yr. annualized	5 yr. annualized	10 yr. annualized
	6/30/2022				
Large Cap Direct Stock Equity	-15.39%	-11.00%	11.28%	11.04%	12.04%
Large Cap Equity ETF	-16.12%	-11.28%	10.29%	10.96%	12.53%
Benchmarks					
Lipper Large Cap Core	-15.50%	-12.00%	8.80%	10.40%	11.90%
Dow Jones Industrial Average	-10.80%	-9.13%	7.10%	9.84%	11.55%
S&P 500	-16.10%	-10.62%	10.60%	11.31%	12.96%
S&P 100	-17.04%	-11.03%	11.64%	11.92%	12.81%

Arcataur Composite Portfolio	Total Return 3 months	12 months	3 yr. annualized	5 yr. annualized	10 yr. annualized
	6/30/2022				
Fixed Income	-4.24%	-9.15%	-0.52%	0.69%	1.49%
Benchmarks					
Bloomberg Barclays 1-5 (T/G/C)	-1.14%	-5.20%	0.12%	1.08%	1.19%
Bloomberg Barclays Aggregate	-4.69%	-10.29%	-0.93%	0.88%	1.54%
Bloomberg Barclays 1-3 (T/G/C)	-0.63%	-3.56%	0.31%	1.07%	1.01%
Lipper Bond MF Avg.	-5.40%	-8.90%	-0.20%	1.00%	1.60%

Arcataur Composite Portfolio	Total Return 3 months	12 months	3 yr. annualized	5 yr. annualized	10 yr. annualized
	6/30/2022				
Managed Balance	-11.32%	-11.75%	5.54%	6.08%	7.56%
Benchmark					
Lipper Balanced	-11.00%	-12.10%	4.00%	4.90%	6.30%
60/40 Custom Index	-9.03%	-9.82%	5.18%	6.12%	7.37%

Arcataur Composite Portfolio	Total Return 3 months	12 months	3 yr. annualized	5 yr. annualized	10 yr. annualized
	6/30/2022				
Small Cap Equity	-14.42%	-17.99%	6.56%	6.54%	10.57%
Mid-Cap Equity	-15.77%	-15.93%	5.87%	6.54%	10.44%
Total Equity*	-14.98%	-14.03%	8.31%	8.64%	10.60%
Benchmarks					
Lipper Small Cap Core	-14.50%	-15.80%	6.20%	5.40%	9.20%
S&P 600	-14.11%	-16.81%	7.30%	7.21%	11.26%
Lipper Mid-Cap Core	-13.60%	-11.50%	6.70%	6.80%	9.90%
S&P 400	-15.42%	-14.64%	6.87%	7.03%	10.90%

Arcataur Composite Portfolio	Total Return 3 months	12 months	3 yr. annualized	5 yr. annualized	10 yr. annualized
	6/30/2022				
Developed International Equity	-13.78%	-18.30%	1.30%	1.92%	4.94%
Emerging International Equity	-9.04%	-21.51%	1.35%	2.63%	2.33%
Total Equity*	-14.98%	-14.03%	8.31%	8.64%	10.60%
Benchmarks					
EAFE	-14.51%	-17.77%	1.07%	2.20%	5.40%
MSCI Emerging Market Index	-10.43%	-25.58%	-0.10%	1.56%	2.33%

*Total Equity is not an actual composite portfolio; rather, Total Equity represents a weighted average return of the Large Cap, Mid-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. Please review complete disclosure information below.

Appendix: Disclosure Information Regarding Composite Performance

General

Arcataur Capital Management LLC is an investment advisor. 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

The composites reflect dollar-weighted returns of individual accounts. Arcataur composites may include some discounted or non-fee-paying accounts, which could cause the net return to be higher than it would be otherwise. Arcataur uses the 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 daily, 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, daily-linked method is used to calculate composite calendar quarter, annual, cumulative and annualized returns. No leverage or derivatives have been used. 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.

Composites

Mutual fund holdings are not included in composite results. Exchange traded funds (ETFs) 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.

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 ETFs). The Arcataur Small & Mid-Capitalization Equity Composites consist of portions of all client accounts invested in small & mid-capitalization equity securities (including ETFs). The Arcataur International Equity Composite consists of portions of all client accounts invested in international securities (including ETFs). The Arcataur Investment Grade Fixed Income Composite consists of 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.

Appendix: Disclosure Information Regarding Composite Performance (cont.)

Fees

The Composite performance figures shown above, are "net" of advisory fees based upon a standard client fee paid during the period including any brokerage fees or commissions that have been incurred within the account. Because the actual management fee paid by an individual client may have been higher or lower, the client's net return may have been higher or lower. The Arcataur Managed Balance composite is based on actual fees paid and may include some discounted or non-fee-paying accounts. The S&P 500® Index, S&P 100® Index, DJIA®, S&P 600® Index, the EAFE® index, the Bloomberg Barclays Investment Grade Index Treasury/Government/Credit (T/G/C) 1-5 Years, and the Bloomberg Barclays Investment Grade Index Treasury/Government/Credit (T/G/C) 1-3 Years returns do not include any 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 are not able to 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, DJIA®, and Lipper Large-Cap Core Average

Arcataur Investment Grade Fixed Income Portfolio –the Bloomberg Barclays Investment Grade Index (T/G/C) 1-5 Years, Investment Grade U.S. Aggregate, and Investment Grade Index (T/G/C) 1-3 Years and the Lipper Bond Mutual Fund Average.

Arcataur Managed Balance Portfolio - Lipper Balanced Fund Average and 60/40 custom total return index which includes: Equities (30% S&P 500, 30% DJIA, 15% S&P 400, 10% S&P 600, 10% EAFE, 5% MSCI-EM), & Bonds (Custom Bond Index consisting of 65% Bloomberg Barclays (T/G/C) 1-5 and 35% Bloomberg Barclays U.S. Aggregate).

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 mid-cap exposure, the mid-cap performance is measured against the S&P 400® Index and Lipper Mid-Cap Core Average. If a client's portfolio contains international exposure, the performance is measured against the EAFE index. If a client's portfolio contains emerging market exposure, the performance is measured against the MSCI Emerging Market Index.

With the exception of the Lipper Balanced Fund Average, the Lipper Large Cap Core Average, the Lipper Bond Mutual Fund Average, the Lipper Small Cap Core Average, and the Lipper Mid-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.

The S&P 500 & S&P 100 are indices of Large-Cap domestic core companies as produced by Standard and Poor's, while the DJIA is produced by Dow Jones. The S&P 400 and S&P 600 are indices of Mid-Cap and Small Cap domestic core companies, respectively as produced by Standard and Poor's. The MSCI EAFE (Europe, Australasia and Far East) Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada. MSCI Emerging Markets ETF is an index composed of large- and mid-capitalization emerging market equities. Both are maintained by MSCI Barra.

Lipper, Inc., a subsidiary of Refinitiv (formerly Thomson Reuters), provides mutual fund comparisons for similar investment profiles. The Lipper Large Cap core universe of mutual funds represents large-cap blend discipline of domestic companies compiled by Lipper, Inc. The Lipper Small Cap core universe of mutual funds represents small-cap blend discipline of domestic companies compiled by Lipper, Inc. The Lipper Mid-Cap core universe of mutual funds represents mid-cap blend discipline of domestic companies compiled by Lipper, Inc. The Lipper Balanced Fund universe of mutual funds

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