Volume 2014, Issue 2

Second Quarter Review
June 2014

ARCATAUR CAPITAL

Arcataur Capital Management LLC
A Registered Investment Advisor

High Quality Investment Management
For Individuals and Institutions

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Inside This Issue:

A Balanced Approach

Summer Breeze

World financial markets had a relatively placid rise over the last four to five months. Low volatility in stock prices and stable interest rates provided positive results for most investors. Earlier in the year, market observers noted dislocations in segments of the broader market. The most notable was how small capitalization stocks lagged; however, by the end of the June these laggards recovered and joined the broader U.S. indices at all-time high price levels.

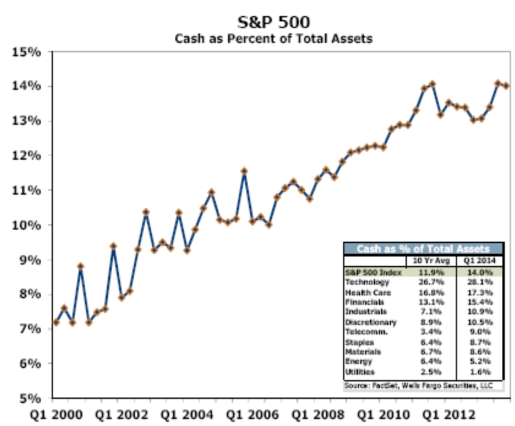
Recently, first quarter GDP was revised from slightly positive to down 2.9% as the harsh winter weather took a toll on consumer and business activity. Positive housing and auto sales in the second quarter, along with improving business spending and production data, are confirming the first quarter weakness was weather related. The tensions in the Middle East and Ukraine have not deflated investor sentiment either as excess liquidity continues to flow to bond and stock investments worldwide.

A 5% to 10% correction is still possible; however, after the 6% pullback in early February market conditions have remained quiet and positive. There were sharper selloffs for high growth momentum stocks in April and May that heightened concerns of a broader correction, but lower interest rates, increased share repurchases and a vigorous resurgence of merger activity have provided the additional fuel to propel stock prices higher.

The recent jobs report provided evidence of improving hiring trends. Unemployment fell to 6.1%, achieving the lowest level in the U.S. since the 2008 credit crisis. The lack of meaningfully higher wages is a key factor for the Federal Reserve to maintain its current low interest rate policy.

Investor complacency could be the most significant threat to stock prices, as historically such low levels of market volatility and liquidity-driven buying could trigger a meaningful reversal without much notice. For now, investors are comforted by the Fed's positioning and reasonable market valuations.

The decline in interest rates in the first six months of the year has been the biggest surprise to investors. The dislocation in the bond market a year ago on the Fed's discussion of reducing its bond buying program has been digested. The termination of the quantitative easing program (now only four months away) has had little impact on investors or consumers.



Source: FactSet, Wells Fargo Securities, LLC

While the investor's current positive sentiment is somewhat susceptible to an unforeseen event or shock that could trigger a correction, U.S. corporations remain cautious with excessive cash reserves. The chart above illustrates how the largest corporations (in total and by industry sector) now carry significantly more cash as a percentage of their total assets compared to fourteen years ago.

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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 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%).

Summer Breeze (cont.)

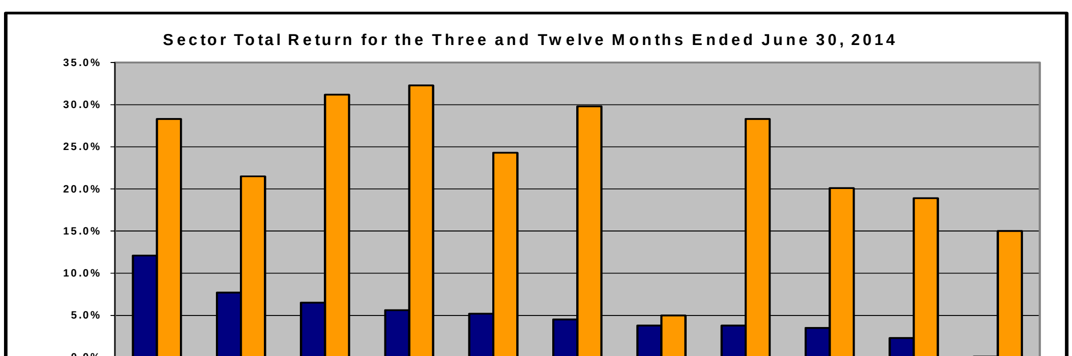
Most of the non-domestic issues that were potentially destabilizing to the world economy have not been resolved, but are currently viewed as less acute. European growth has been lackluster, but improvements are emerging and the most dire concerns have diminished significantly. China and the emerging markets continue to have potential risks as well, but international stock valuations appear to reflect these potential risks. Middle East tensions remain elevated and, although the concerns over Iran's nuclear program are still noteworthy, the gains of the terrorist group ISIS in Syria and Iraq may have become more threatening in the near term. World energy prices are elevated. However, due to the increased domestic production in the U.S., the international tensions have caused a more muted response in commodity prices. The domestic energy resurgence is the focus of our special section at the bottom of page 4 of this newsletter.

As expected, the political news out of Washington has been extremely quiet. Immigration, tax policy and mortgage finance reform have been highlighted, but no potential legislation is expected as the mid-term elections are now four months away. Many of the proposed mergers of U.S. corporations with foreign counterparts have highlighted the tax differential and benefits of tax inversions (re-domiciling to the lower tax country). Some in Washington view this as a reason to address a broader tax policy change, while others support a restrictive measure on tax inversions.

The second quarter earnings reports due in mid-July are anticipated to be better than the first quarter, but weather-related delays spilled over to April and May. Forward-looking guidance will be more critical than usual based upon the circumstances.

April and early May produced a sideways move in stocks, while in the latter half of the quarter equity prices moved up to meaningful new highs. The S&P 500 (total return) was up 5.2% in the quarter. The smaller capitalization (illustrated by the S&P 600 Small Cap Index) issues increased by 2.1% for the quarter, while the NASDAQ Composite rose by 5.3%, and the Dow Jones Industrial Average was up 2.2%. Developed international markets were up 2.6%, while the oversold emerging markets had a meaningful snapback and were up 5.6% in the quarter.

The energy sector was the standout leader in the quarter due to the Middle East tensions, while most of the other sectors were up relatively with the broader averages. The consumer staples sector was essentially flat and the worst performing for the quarter. This relates to some high profile earnings misses reported in April and May. In general, multinational blue chip companies continued to out-perform the broader averages across many sectors. The chart below illustrates how all the sectors performed in the quarter and for the trailing twelve months.



	Energy	Utilities	Info.Tech	Materials	S&P 500	Healthcare	Telecom	Industrials	Consumer Discretion	Financials	Consumer Staples
3 Months	12.1%	7.7%	6.5%	5.6%	5.2%	4.5%	3.8%	3.8%	3.5%	2.3%	0.1%
12 Months	28.3%	21.5%	31.2%	32.3%	24.3%	29.8%	5.0%	28.3%	20.1%	18.9%	15.0%

Source: Baseline

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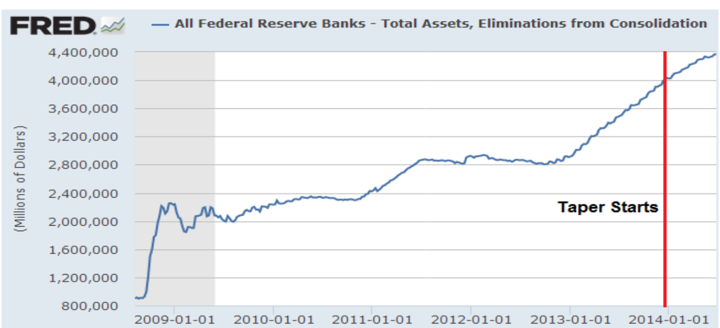
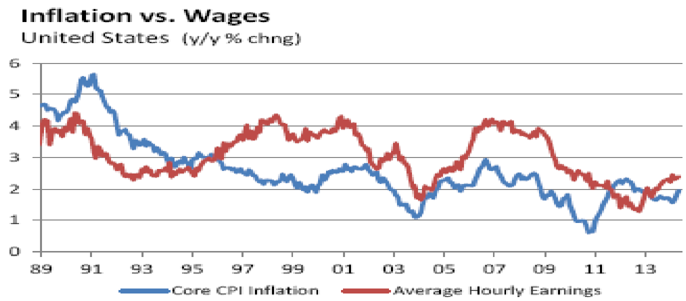
Steady as she goes

The Federal Open Market Committee (FOMC) shrugged off disappointing economic growth in the first quarter and opted to continue to taper (reduce) its monthly asset purchases by a total of $20 billion (a cut of $10 billion at each of last 2 meetings), reducing the amount to $35 billion. Fed officials cited a temporary, weather-related impact on economic activity early in the year and pointed to signs of improvement in employment, manufacturing and consumer confidence during the second quarter in deciding to continue its steady pace of tapering. There are 4 more FOMC meetings scheduled for this year, and if the Fed stays on this steady course of tapering, this latest quantitative easing (QE) program will likely wind down before the end of the year. Investors are now turning their attention from the end of QE to when the Fed will begin to raise the federal funds rate. The Fed seems to be in no rush to tighten monetary policy and has reiterated that short-term rates will remain near zero for a "considerable time", which could be well into 2015. Despite decreasing the amount of stimulus it was injecting into the economy, the Fed's balance sheet remains inflated at $4.33 trillion, up from $4.2 trillion three months ago.



Source: Federal Reserve & pragmatic capitalism

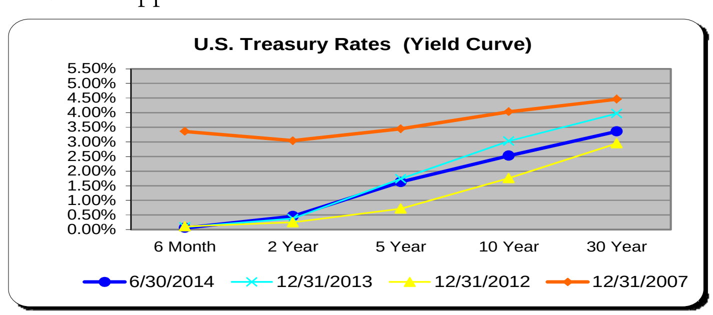
The Fed continues to focus on trends in the labor market, including the unemployment rate, the length of unemployment, underemployed workers, labor-force participation rate and wage growth. In the latest employment data, the unemployment rate improved to 6.1% from 6.3% the month before. The labor-force participation rate was unchanged at 62.8% month-over-month, a multi-decade low and down from 63.5% a year ago. Fed Chair Janet Yellen has focused on the low participation rate, long-term unemployment and low wage growth as areas of concern in the labor market. Wage growth for June actually declined from 2.1% to 2.0%, meaning real wages are barely keeping up with inflation. These structural problems in the work force may mean the Fed will tolerate inflation being higher than its 2% target until it feels the economy is at full employment. The challenge for the Fed will be to communicate its policy intentions through forward guidance, which is not expected until "later this year", according to Ms. Yellen. Any change in the current zero-interest-rate-policy will be data-dependent.



Source: Bureau of Labor Statistics/Haver Analytics

Coming into 2014, the consensus was that interest rates would slowly rise over the course of the year as the Fed unwinds its monetary stimulus. Instead, interest rates declined, confounding most investors. Several factors drove rates lower including geopolitical concerns (Iraq, Ukraine), slower global economic growth, waning Treasury issuance due to improving budget deficits, a supply/demand imbalance and low inflation expectations. In addition, as the Fed moves to exit its QE programs and prepares to begin to normalize interest rates, other foreign central banks are moving in the opposite direction, lowering rates in an attempt to stimulate their economies. For this reason, we expect global interest rates, including the U.S., will stay low and liquidity will remain high for at least the rest of this year and perhaps into 2015.

Based on current inflation expectations, real 10-year U.S. Treasury yields (adjusted for inflation) are less than 0.5%, meaning that investors are getting very little yield for increasing risk. Prior to the 2008 financial crisis, the real 10-year Treasury yield averaged between 1.5% and 2.5%. There is little absolute value in most fixed income sectors, including investment grade corporate bonds, where spreads over Treasuries are at near record low levels. Given the current low yields on bonds, we have not been actively adding exposure to client accounts, and cash levels are above average as we wait for better opportunities.



Source: Baseline

With the U.S. economy showing signs of rebounding and the Fed still winding down its bond purchase program, interest rates should begin to inch up again. We look for the yield on the 10-year Treasury to move back to the 3% area in the second half of this year, below the pre-crisis level of 5%. Inflation expectations remain muted and there is still slack in the labor market, which gives the Fed leeway to keep the fed funds rate near zero for longer than normally expected.

Third Quarter 2014 Investment Outlook

Stocks produced multiple new highs in the first half of the year. For the remainder of the year the upward trend is expected to continue; however, the likelihood of a correction in the near term is increasing. The U.S. economy is expected to show improving growth, and a more meaningful increase in inflation indicators is required to accelerate the Fed's less accommodative interest rate policy.

The stock market seasonalities have confounded investors thus far. The typical early summer pullback did not materialize, and the historical election cycle where weakness in the months prior to the mid-term elections is suspect, too. The liquidity available in the economy has fueled the rise in stock prices in the face of geopolitical risks and questionable economic data earlier in the year.

We view the interest rate outlook as a critical determinant of economic growth and the overall risk/return potential facing investors. The unemployment rate has dropped recently to 6.1% which previously was viewed as an action level for the Fed to start the process of normalizing interest rates. Currently the quantitative easing program is expected to be completed at the end of the third quarter, but an actual interest rate increase from the Fed is not anticipated prior to the third quarter of 2015.

A definitive rise in interest rates will be a significant change for bond and stock investors. A defensive position in bonds will be important during this process, and stock volatility will also increase.

The Fed currently wants to see a confirmation of improved labor trends before it is convinced it is safe to raise interest rates. Over the last four years wage inflation has remained at or below 2%, while the long-term average is closer to 3.5%. While unemployment has hit a five year low, there is still considerable slack in the labor market. There are over 3 million long-term unemployed today versus a 2 million average, and 7.4 million part-time workers versus an average of 3 million. This slack is a focus of the Fed and is one of the last remaining vestiges of the recession post the credit crisis of 2008.

We continue to believe investors will push up interest rates prior to the Fed's first raise, but this will only happen with a meaningful acceleration in world economic growth. Based upon current data, a rise in interest rates may begin later this year and into 2015. The transition phase will potentially change investor sentiment and market volatility as well.

At this stage of the investment cycle, a 5% to 10% correction could provide a cleansing period to set up for future appreciation. Valuations would improve, assuming reacceleration in corporate profits in the latter half of the year. The one historical tendency of the second year of the four-year Presidential cycle is to produce weak stock prices the 3 to 5 months prior to the mid-term elections, but to then produce the strongest returns of the four year cycle the following 9 months. While these historical considerations are interesting, the important factors of corporate earnings growth, employment, inflation and how interest rates normalize will be key to determine what kind of future is in store for investors.

Within our large capitalization direct portfolios, we utilized recent strength to pare some stock holdings and reposition overall exposure where appropriate.

Our high quality fixed income portfolio is maintaining a defensive and liquid position. During the recent rally in bonds, we moved to reduce duration in client portfolios. Owning bonds in a rising rate environment is tricky, but maintaining a shorter duration should minimize the market value risk.

Our Managed Balance portfolios continue to maintain an above average exposure to stocks, as valuations and relative attractiveness favor equities over bonds. The recent strength has allowed for minor shifts in total exposure.

U.S. energy renaissance - where's the beef?

American consumers have yet to realize a significant gasoline price drop despite dramatic increases in domestic energy production; however, the ballyhooed fracking revolution probably has muted the much higher prices frequently experienced when Middle East production is threatened. A closer look at global oil markets reveals that the substantial increase in U.S. oil and natural gas production due to advanced horizontal drilling techniques combined with fracking has been the key factor in preventing additional major increases in oil and prices at the pump. As the developing markets (especially China and India) emerge as modern economies, their demand for energy increases markedly. So even though U.S. demand for oil weakened due to the 2008 recession and has remained subdued due to the subpar recovery, better fuel efficiency in the vehicle fleet, and fewer miles driven, demand for oil continues to rise inexorably. At the same time, some of the largest, longest-lived reservoirs of oil like Beaufort, the North Sea, and Mexico's Cantarell Field are in sharp decline. There are some potential disruptions in oil production with the recent geopolitical upheavals in oil-producing regions like Libya, Egypt, and Iraq and disappointing drilling results in high potential fields in Brazil and Africa. Given these supply-demand dynamics, which in prior episodes would have resulted in sharp price hikes and extremes in volatility, it is notable how quiet the energy markets have been. In 2007 and 2008, with arguably lesser supply-demand strains, oil prices spiked to $145/bbl. Today, Brent crude prices have remained in a narrow range near the $110 level and the growth in U.S. production is an essential factor in the relative calmness of crude prices. With domestic production forecasted to grow from today's 8mm barrels per day (5mm in 2007) to 12mm barrels over the next few years, the relatively quiescent oil markets may persist, barring some catastrophic geopolitical event. So while increased production has not been reflected directly in lower prices at the pump, it has reduced the potential of a dramatic spike of gas prices over $4.

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Arcataur Composite Investment Performance for the 3 Months, 12 Months, 3 Years and 5 Years Ended June 30, 2014

Arcataur Composite Portfolio	Total Return 6/30/2014: 3 months	12 months	3 yr. annualized	5 yr. annualized
Large Cap Equity	5.12%	25.23%	15.97%	17.39%
Benchmarks				
Lipper Large Cap Core	4.59%	23.54%	15.07%	17.32%
S&P 500	5.23%	24.61%	16.58%	18.84%
S&P 100	5.01%	22.87%	16.51%	17.70%

Arcataur Composite Portfolio	Total Return 6/30/2014: 3 months	12 months	3 yr. annualized	5 yr. annualized
Fixed Income	2.42%	3.95%	3.30%	4.32%
Benchmarks				
Citi BIG 1-5 (T/G/C)	0.65%	1.87%	1.67%	2.68%
Citi BIG (T/G/C)	1.90%	4.24%	4.12%	5.13%
Lipper Bond MF Avg.	1.85%	5.24%	4.05%	6.36%

Arcataur Composite Portfolio	Total Return 6/30/2014: 3 months	12 months	3 yr. annualized	5 yr. annualized
Small Cap Equity	2.02%	25.55%	16.24%	21.25%
International Equity	3.68%	19.53%	3.39%	9.16%
Total Equity*	4.22%	24.56%	14.25%	17.28%
Benchmarks				
Lipper Small Cap Core	2.48%	23.73%	12.76%	19.79%
S&P 600	2.07%	25.54%	16.81%	21.98%
EAFE	2.64%	19.97%	4.80%	8.51%
S&P 500	5.23%	24.61%	16.58%	18.84%

Arcataur Composite Portfolio	Total Return 6/30/2014: 3 months	12 months	3 yr. annualized	5 yr. annualized
Managed Balance	3.54%	18.33%	10.94%	13.11%
Benchmark				
Lipper Balanced	3.40%	15.24%	9.06%	11.91%
60/40 Custom Index	2.86%	14.44%	9.44%	11.55%

*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 Global Investment Performance Standards (GIPS) of the CFA Institute 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. The CFA Institute has not been involved in the preparation or review of this report. Arcataur is not claiming GIPS compliance.

The composites reflect dollar-weighted returns of individual accounts. Arcataur uses the GIPS 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.)

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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 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.

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 2 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.