

INVESTOR UPDATE

Matterhorn
CAPITAL MANAGEMENT, LLC

2ND QUARTER 2010

2Q2010 EXECUTIVE SUMMARY

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Outlook

Forecasting an outlook for the vastly complex global financial system is a perilous task, yet inevitably required in our business. We publish a snapshot of our outlook every quarter, even though we constantly modify our thesis based on the dynamic nature of the system. This recording discipline encourages diligence in forming our opinions and provides a framework in which to deploy our bottom-up investment process.

Adjustments

Last quarter we published an outlook that was negative for the short- and long-term, but positive medium-term. Our short-term view was influenced by persistent volatility and our opinion that the market was fundamentally overvalued. Healthy company earnings expectations supported by a return to global economic growth drove our positive medium-term outlook, while weak developed market balance sheets made us turn negative in our long-term view.

What has changed since last quarter? The pullback in May and June illustrated the frailty of an overvalued market enveloped in a debt crisis. We realized that the ongoing debt crisis will influence investment markets more than anticipated. Volatility

All-Cap Equity Composite Performance (Net of Fees) As of 06/30/10

	QTD	YTD	Ann ITD ¹
MCM Global Core²	(9.41)	(5.73)	3.28
Core Equity Blend Index ³	(12.22)	(8.72)	(0.79)
MCM International⁴	(10.95)	(10.28)	0.46
MSCI World ex U.S. Index	(13.31)	(12.43)	(5.61)
S&P 500 Index	(11.86)	(7.57)	(2.27)

¹ Inception date 4/14/05

² Composite contains U.S. Growth, U.S. Value, International and Global Core accounts.

³ Blended index consists of two-thirds Russell 3000 Index and one-third MSCI World ex U.S. Indices.

⁴ Inception to date 9/30/2006 and 3-year returns annualized.

Note: Index returns do not include dividend payments or reinvestment of dividends.

is going to persist until the uncertainty of long-term growth is solved or at least temporarily removed. For that reason our focus this quarter is to review the history of debt crises in order to anticipate possible outcomes of our current dilemma. The most probable scenarios give us a framework to adjust our long-term outlook and sharpen our short-term portfolio positioning. Please refer to our theme section for more about global debt crises. ■

Exhibit 1: Contribution to World GDP

	GDP, U.S. Dollar Billion, Current Prices						Percent of Global GDP					
	1989	1994	1999	2004	2009	2014	1989	1994	1999	2004	2009	2014
World	20,557	26,725	31,180	41,998	57,937	77,132	100%	100%	100%	100%	100%	100%
Major Developed Economies*	12,973	18,062	20,694	26,209	30,991	37,023	63%	68%	66%	62%	53%	48%
European Union	5,847	7,973	9,150	13,182	16,447	18,807	28%	30%	29%	31%	28%	24%
USA	5,482	7,085	9,354	11,868	14,256	17,490	27%	27%	30%	28%	25%	23%
Japan	2,952	4,779	4,369	4,606	5,068	5,972	14%	18%	14%	11%	9%	8%
Emerging & Dev. Economies	4,794	4,736	5,910	8,997	17,881	28,995	23%	18%	19%	21%	31%	38%
Developing Asia	1,128	1,504	2,151	3,503	7,793	13,105	5%	6%	7%	8%	13%	17%
China	451	559	1,083	1,932	4,909	8,415	2%	2%	3%	5%	8%	11%
Central and Eastern Europe	435	391	585	986	1,615	2,223	2%	1%	2%	2%	3%	3%

* G7 Countries: Canada, France, Germany, Italy, Japan, United Kingdom, and United States

Source: IMF

Economic Outlook

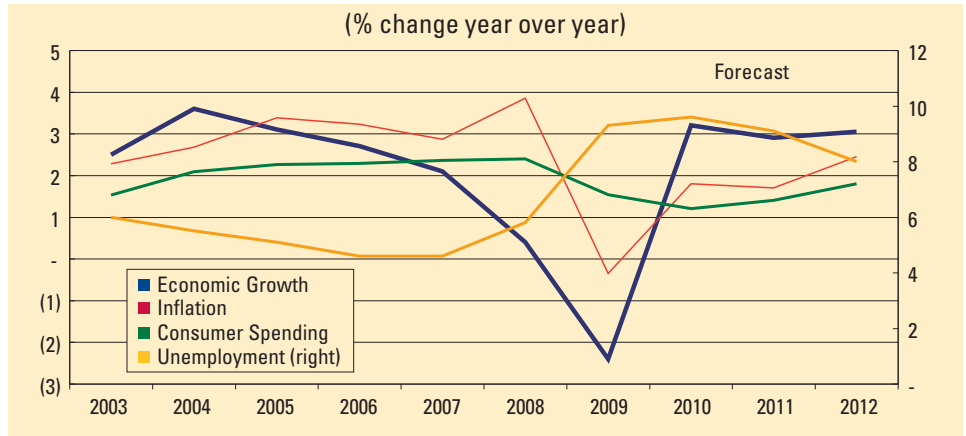
There are large long-term challenges facing developed economies after the debt-driven recession. Nevertheless, we are confident in the resilience of free markets and remain positive medium-term with the following adjustments to our outlook last quarter:

1. Short-Term Pullback: In the first two quarters of 2010, U.S. GDP growth (a proxy for global growth) was assisted by sharp inventory rebounds as businesses restocked inventories cut during the recession. The last four quarters were also the apex of the fiscal stimulus packages.¹ We anticipate a mild pull back in global GDP growth over the second half of 2010 as the effect from both the inventory rebound and fiscal stimulus recedes.

2. European Adjustments: We do not anticipate a “double-dip” recession in 2011, but we do expect lower GDP growth than we forecast last quarter. Economists will reduce estimates as the European debt crisis and the resultant austerity measures impact growth world wide. Until May 2010, economists’ growth estimates steadily climbed, but have since retracted as the case for a slow recovery from a debt-driven recession built and fears of a second leg of the recession rose.

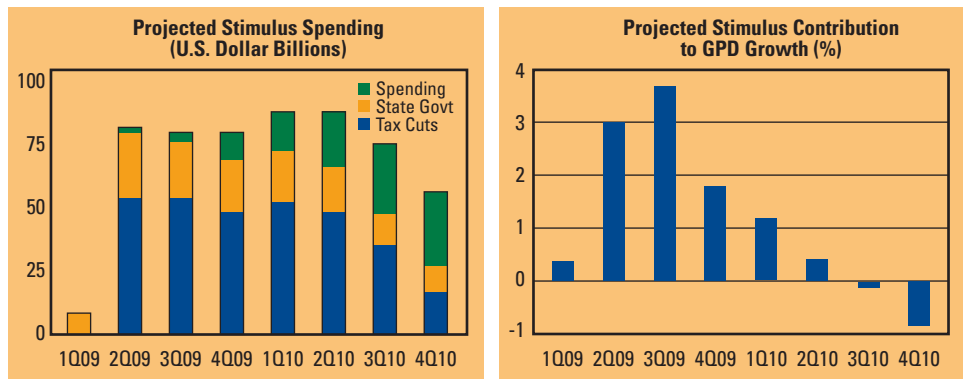
3. Capital Investment Rebound: Private capital investments will fill some of the gap left by receding inventory rebounds and fiscal stimulus. Healthy balance sheets and soaring margins will provide impetus for companies to invest in future growth.

Exhibit 2: U.S. Economic Activity



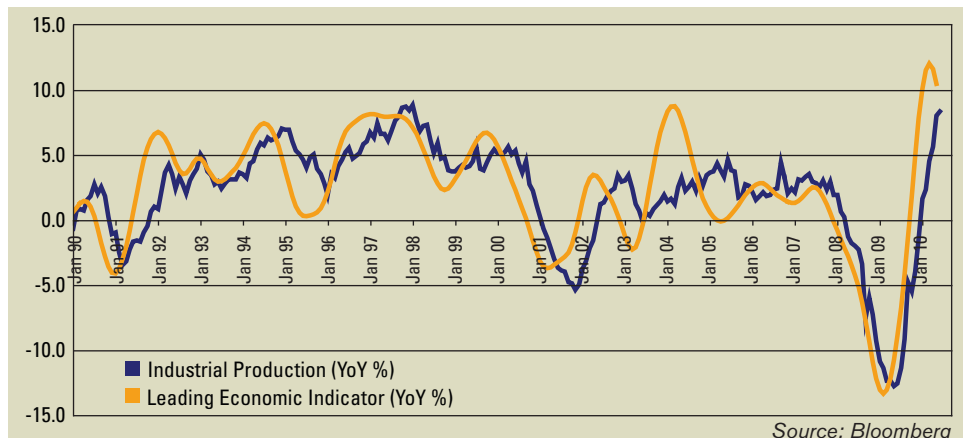
Source: Bloomberg

Exhibit 3: 2009 U.S. Fiscal Stimulus



Source: Moody's Economy.com

Exhibit 4: U.S. Economic Rebound



Source: Bloomberg

4. Consumer Spending Resilience: Despite a deleveraging trend in place for the U.S. consumer and some weakness in June retail sales numbers, our consumer spending outlook is positive at the margin.

Growth in temporary workers and the National Federation of Independent Business (NFIB) job hiring survey indicate that companies may invest in labor, as they have in (continued next page)

¹ For example, the American Recovery and Reinvestment Act of 2009 (ARRA) in the U.S.

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16410 Blanco Road, Suite 2
 San Antonio, TX 78232
 (210) 694-4329 Telephone
 (210) 694-4379 Fax
 www.matterhorncap.com

Economic Outlook (continued from 2)

inventories and will in capital equipment, to fuel growth. In our individual company research, we have found unremitting references to the emerging consumer in developing countries as an area of growth. A burgeoning emerging consumer

supported by a recovering U.S. labor market will be the foundation of growth in global GDP.

5. Export Spark: The U.S. economy may find a positive medium-term surprise from

rising exports as developing country currencies appreciate and emerging consumers are drawn to U.S. products and services. ■

Market Outlook

The precarious market position created by the prospect of doubtful economic growth and an overvalued market directs us to be cautious. The market is indeed precarious because it has, in our opinion, the probability of rising or falling 10 to 20% from quarter-end levels by the end of the year. Uncertainties to be resolved are: a) developed market financial stress relief, b) the strength of developing market economic growth and c) the timeline for U.S. employment recovery.

Our cautious disposition is reflected in the higher-than-normal cash positions held at the end of the quarter; we do not have a predetermined date by when to reinvest the cash. We will nonetheless look for buying opportunities in securities that pass our investment process, provide a fundamentally and technically opportunistic entry price and specifically meet the following criteria:

1. Companies with healthy balance sheets that exhibit flexible capital funding for

growth, industry-beating margins for safety and stable revenue sources;

2. Companies operating in or sourcing revenue from countries where governments meet a minimum interest coverage threshold currently and are projected to do so in the medium-term future;

3. Companies profiting from the production of select fundamentally attractive commodities; and

4. Entities that profit from emerging market consumer spending. ■

Debt & Deleveraging Theme



"The national budget must be balanced. The public debt must be reduced; the arrogance of the authorities must be moderated and controlled. Payments to foreign governments must be reduced, if the nation doesn't want to go bankrupt. People must again learn to work, instead of living on public assistance."

~ Cicero (106 BC - 43 BC), 55 BC

Cicero's quote is notable not only for its timeless relevance, but for its historical context, dating back to the last days of the Roman Republic – a time of great political upheaval and economic uncertainty, not unlike our present situation. The underlying prescription of austerity, debt reduction and limits on social welfare systems tells us that the issues we now face are as old as the concept of government itself. This is not new, and while some may argue that "this time is different," an eponymous best-selling book² argues fairly convincingly that it is not. With the current market uncertainty stemming primarily from the interlinked issues of global debt and deficits, we take a closer look at the global debt problem and what the trend toward deleveraging and eventual austerity are

likely to mean for economic growth going forward. We focus our analysis on the U.S. economy given its relevance to our investor base, as well as its use as a proxy for debt and deficit issues throughout the developed economies. We begin by framing the debt problem in terms of its root causes and explain why its scale makes it particularly challenging. We then discuss the various scenarios for deleveraging and conclude by outlining our investment strategy for the most likely outcomes.

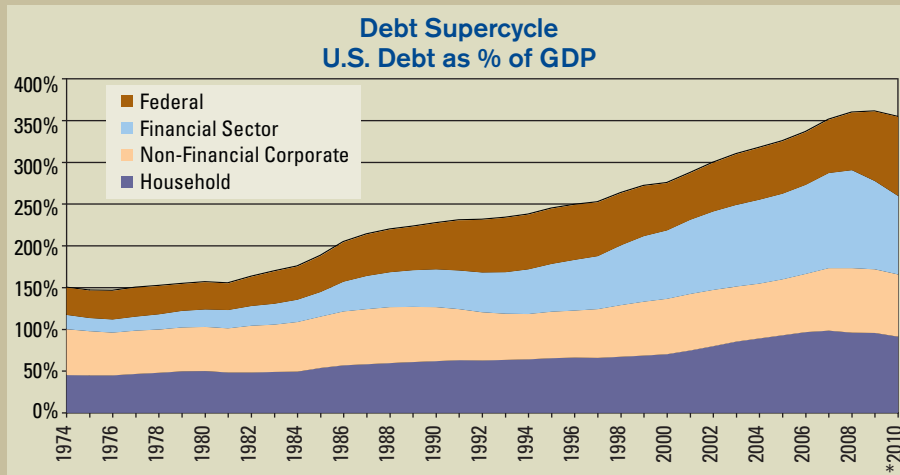
How We Got Here – Debt Supercycle

To understand how we got here, one must understand why consumers, companies, banks and countries borrow in the first place. Debt is an intoxicating elixir, capable of helping consumers boost their standard of living (by pushing consumption forward) while helping companies boost their growth. Access to low-cost capital, coupled with population growth, technological innovation and productivity gains over the past 30 years, meant that as our collective standard of living improved, so did our aggregate demand for assets. As asset prices increased, so did the capacity to lend, since the increase in the value of the underlying asset (collateral)

(continued next page)

²Reinhart, Carmen M, and Kenneth S. Rogoff, "This Time Is Different: Eight Centuries of Financial Folly," Princeton, N.J., Princeton University Press, 2009.

Theme (continued from 3)



Source: Bureau of Economic Analysis, Office of Management and Budget, Flow of Funds Account of the U.S. - Federal Reserve. *1st Quarter

served to drive loan-to-value ratios even lower. Against the backdrop of low interest rates and productivity-fueled economic growth, debt levels exploded. By the time the financial crisis hit in 2008, aggregate debt levels in the U.S. approached 360% of GDP, up 50% from 1990 levels and nearly double from 1980 levels.³

Since the crisis, we have witnessed a massive transfer of debt from the private sector to the public sector, driven primarily by the government's role as the lender of last resort in its effort to keep the financial system afloat. While we have recently begun to see some deleveraging at the household and company level, the increase in government debt has meant that aggregate debt levels have remained relatively unchanged. If history is any guide, we can expect the external portion of this aggregate debt to increase. In their book, *"This Time is Different,"* which analyzes 800 years of data on emerging and developed economies, Reinhart and Rogoff found that external debt levels (which includes government and private debt) usually increased by 80% (on an absolute basis as a percentage of GDP) within three years after an economic crisis.⁴ As of the end of 2009, the U.S. external debt/GDP ratio stood at 84%. According to Rogoff, that ratio is likely to exceed 90% sometime over the next 12 to 24 months.

Scope of Problem - Why Excess Debt is Problematic

The 90% threshold is key, since median GDP growth rates have been shown to fall by 1% once a country's external debt exceeds 90% of GDP.⁵ This means that once debt becomes excessive, countries cannot grow their way out of

³The Economist; U.S. Bureau of Economic Analysis; U.S. Federal Reserve.
⁴Huebscher, Robert, "Ken Rogoff Expects Slow Growth and Sovereign Debt Defaults," *Advisor Perspectives*, May 25, 2010.
⁵Reinhart, Carmen M. and Kenneth S. Rogoff, "Growth in a Time of Debt," *American Economic Review Papers and Proceeding*, January 2010.

the problem. They must proceed through the time-consuming and painful process of debt repayment and increased saving, which could have a negative impact on consumer spending in the absence of real income growth. New research from the McKinsey Global Institute shows that for each percentage point increase in the U.S. savings rate, consumer spending drops by more than \$100 billion – a serious drag on any recovery. The importance of consumer spending cannot be understated, given that U.S. consumers have accounted for more than three-quarters of U.S. GDP growth since 2000 and for more than one-third

of global growth in private consumption since 1990.⁵

While the U.S. has not yet reached the 90% tipping point, looming state and local budget shortfalls combined with pension fund imbalances will likely push the federal deficit to the point at which creditors will begin to demand higher interest rates for U.S. debt. Given the sheer scale of the debt, even incremental changes to interest rates can (and will) create a funding and fiscal crisis. Unfortunately, history has shown us that when it comes to tackling the deficit, governments are not prone to act proactively, especially since tough austerity measures are not popular with voters.

In fact, most respond in ways that initially exacerbate the situation. It is only in times of crisis that constructive measures are taken, since only then are legislators given a political "free pass" to attack the deficit through painful austerity measures. In the U.S., these measures will almost certainly include a substantial increase in taxes, (continued next page)

What We Have Learned From History

What Governments Don't Do With World War Size Debt

- 1. Slash expenditures on entitlements.
- 2. Reduce marginal tax rates on income and corporate profits to stimulate growth.
- 3. Grow their way out without defaulting or depreciating currencies.*
- 4. Raise taxes on consumption to reduce deficits.

What Governments Usually Do With World War Size Debt

- 1. Restrict overseas investment by firms and citizens
- 2. Oblige central bank and commercial banks to hold government debt.
- 3. Default on commitments to politically weak groups and foreign creditors.
- 4. Condemn bond investors to negative real interest rate

* Sole exception is Britain 1815-1913 as it was undergoing the Industrial Revolution. Source: Niall Ferguson, "Fiscal Crises and Imperial Collapses," *Peterson Institute for International Economics*, May 2010.

Theme (continued from 4)

Deleveraging Scenario Analysis

Ratios	Options	Description	Probability	Economic Consequences
Debt/GDP	Excessive (>90%)	Austerity — Increased savings & debt repayment	High if debt ratio exceeds 90%	Low growth/high inflation Median GDP growth falls by 1%
		Default — Partial/full default: restructuring	Low U.S. can always print its way out	
	Not Excessive (<90%)	Austerity — Increased taxes and cuts in public spending (entitlements)	Medium Austerity likely only in crisis	6-7 years of deleveraging in which the debt/GDP ratio declines by 25% GDP contracts for 2-3 years
		Inflation — Printing money: quantitative easing	Medium QE likely to remain in place	Liquidity sets stage for next crisis Obviously, highly inflationary
Default — Partial/full default: restructuring		Low U.S. can always print its way out		
	High Growth	High growth driven by net exports, war, oil booms or productivity	Low Unemployment overhang and lack of export alternatives	

Source: McKinsey Global Institute, Kenneth Rogoff, Matterhorn Capital Analysis

as well as significant cuts to (politically charged) entitlement programs like Medicare, Medicaid and Social Security.

Scenario Analysis

Taking into account the existing debt load, as well as lessons from history, what are the deleveraging options available and which are most likely to be implemented? According to a study conducted by McKinsey Global Institute, historical episodes of deleveraging fall into four general archetype: "Belt Tightening," "High Inflation," "Massive Default" and "Growing Out Of Debt."⁷

Assuming the U.S. debt-to-GDP ratio stays below the 90% level, the most likely scenario is inflation (printing money), followed by austerity. Given the Federal Reserve's bias toward keeping rates low for the foreseeable future, quantitative⁸ easing will likely continue indefinitely – at least until the Fed is convinced the economic recovery is sustainable without government stimulus.

So what can we expect? Reinhart and Rogoff's data show that the average peak-to-trough decline in the economy lasts

12 to 18 months, followed by a recovery of the same duration, with high unemployment lasting for 4 to 5 years.⁹ Given how closely the U.S. has tracked these historical patterns, we would expect another 2 to 3 years of high unemployment along with muted GDP growth.

Investment Strategy

Against the backdrop of sluggish growth in (high debt) developed world countries and rising prominence of (high growth) developing economies, we are shifting our long-term strategy to increase our exposure to fiscally responsible, stable growth countries.¹⁰ In particular, we are looking for companies operating in or sourcing revenue from countries where governments meet a minimum interest coverage threshold. These stocks will augment our existing exposure to these countries, including Bank of Nova Scotia (Canadian bank), Canadian Natural Resources (Canadian oil and natural gas), Potash (Canadian fertilizer manufacturer), Research in Motion (Canadian smartphone manufacturer), AsiaInfo Holdings (Chinese IT), CPFL Energia (Brazilian utility) and Yangzhou Coal (Chinese Coal Miner). ■

⁶U.S. Bureau of Economic Analysis, U.S. Federal Reserve, McKinsey Global Institute Analysis.

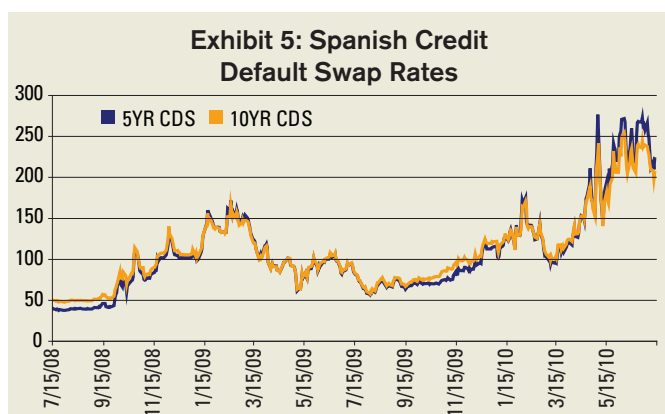
⁷Roxburgh, Charles and Susan Lund, "Debt and Deleveraging: The Global Credit Bubble and Its Economic Consequences," McKinsey Global Institute, January 2010.

⁸The term quantitative easing describes a form of monetary policy used to increase money in an economy when the interbank interest rate (Fed Funds in the U.S.) is either at, or close to, zero (ZIRP). Essentially, the central bank purchases financial assets (mostly short-term), including government paper and corporate bonds, from financial institutions using money it has created. Quantitative easing is sometimes described as 'printing money,' although the central bank actually creates it electronically 'out of nothing' by increasing the credit in its own bank account. "Q&A: Quantitative Easing." BBC. 2009-03-09; Quantitative easing explained, FT.com; Wikipedia.

⁹Huebscher, et al.

¹⁰Examples of countries exhibiting these characteristics include Canada, India, China, Brazil, Denmark and Sweden.

Market Review



Source: Bloomberg

Last quarter investors nervous about the global debt problem sent U.S. and global indices sliding by double digits.¹¹ Most of the declines occurred after April when acceptance that there was a debt problem spread and investor focus swiftly moved to the most vulnerable economic region – Europe – and its weakest link – Greece. Hasty plans for a European Union and International Monetary Fund aid package

tightening from the Chinese regime and alarming anecdotal real estate statistics.

A jittery market next lost confidence in the Irish, Spanish and Portuguese governments' abilities to repay maturing sovereign debt and caused funding problems for European banks. The loss in confidence, despite the announced aid package, is illustrated by credit default swap rates for Spanish sovereign debt.

to Greece early in the quarter did not squelch market fears during May.

At the same time, the significance of Chinese economic growth to the global recovery bubbled to the surface of the cauldron of concerns. Investors doubted the strength of predicted Chinese growth amid signals of monetary

The correction in the quarter was widespread across countries, sectors, market caps and investment styles. In fact there was almost no difference among small-, mid- and large-cap stocks or value and growth style indices. All sectors also declined with the worst hit Energy, Materials, IT and Financials. Least impacted were Consumer Staples, Utilities, Telecom and Healthcare. Countries most impacted were those with highlighted debt problems: Greece, Hungary, Spain and Italy. China was quite weak also driven by growth pullback fears. Very few countries reported currency-adjusted positive returns that were not rebounds from previous country specific weaknesses. Exceptions were Indonesia and the Philippines that clearly broke a correlation trend with developed world markets. ■

¹¹Russell 3000, S&P 500 & MSCI AC World ex U.S. indices.

Portfolio Review

Our cautious disposition grew during the last three months, with cash positions exceeding 20% by the end of the quarter. The above-average cash positions contributed to our outperformance. We sold a total of eight stocks last quarter for various reasons (please refer to the portfolio sales section), and did not reinvest the cash.

The U.S. Core portfolios outperformed in the IT, Materials and Energy sectors and underperformed in both consumer sectors (Staples and Discretionary). As usual in a volatile period, we had individual names that performed very well and those that disappointed. Hugoton Royalty Trust (HGT), Lincare (LNCR) and Pactiv (PTV) performed best as firming natural gas prices, an improving medical regulatory environment and acquisition speculation

drove prices respectively. Our weakest stocks were Transocean (RIG), impacted by the oil spill, as well as NBTY (NTY) and True Religion Apparel (TRLG), impacted by weakening retail sales and margins.

The International portfolios found outperformance in the Healthcare and Utilities sectors and weakness in IT and Industrials. CPFL Energia (CPL – Brazilian utility), AstraZeneca (AZN – Anglo-Swedish pharmaceutical) and Chunghwa Telecom (CHT – Taiwanese telecom) performed best. CPL and CHT provided stable returns as defensive utilities in healthy economies should, while AZN was boosted by a patent protection ruling. Weakest stocks were Research in Motion (RIMM)

facing an increasingly competitive smart phone market, Potash (POT) and Yanzhou Coal (YZT) both impacted by fears of a slowdown in Chinese economic growth. ■

Some stocks – such as Nature's Bounty, a nutritional supplement company – were impacted by weakening retail sales and margins.



U.S. Growth Portfolio Transactions

Portfolio Sales

Gilead Sciences, Inc. (GILD)

Large-Cap, Healthcare

We made a decision to sell out of our position in Gilead shortly after the company reported disappointing quarterly sales for its core HIV drugs and significantly lowered its full-year forecast due to the passage of U.S. healthcare reform. The reforms require drug makers to offer higher price rebates for government-funded health plans. As a result of these measures in the U.S., the company is facing increased pricing pressures from governments around the world intent on reducing pharmaceutical expenditures through a combination of increased rebates, cancellations and callbacks of price increases. All of which have a significant impact on profit margins.

In addition, the company also announced it was terminating a study of an experimental drug for hepatitis C due to the level of toxicity. With an unsuccessful hepatitis C testing program, softness in their core HIV revenue and increasing uncertainty regarding their pipeline as key patents begin expiring in a few years, we decided to sell out of the stock.

Orion Marine Group, Inc. (ORN)

Small-Cap, Industrials

Given the uncertain economic environment and increasingly risk-adverse sentiment

in the market, we decided to make some tactical moves to lower the overall risk profile of the portfolio. This included selling out of some of our "riskier" smaller cap, economically sensitive (cyclical) names like Orion Marine Group.

The biggest risk in holding a stock like ORN was that a longer-than-expected economic recovery would threaten (or delay) public and private investments in marine infrastructure, which in turn would materially impact the company's revenue and earnings growth. Our original investment thesis (infrastructure/stimulus play, sizeable market) is still valid. However, we decided that the risk of a project delay and/or cancellation over the near-to-medium term given state and local funding pressures along the Gulf Coast was quite high. The resulting hit to valuation would provide us with a much more attractive entry point.

PetMed Express (PETS)

Small-Cap, Consumer Staples

Our sell discipline calls for selling out of a stock if the stock price has reached our predetermined price target or if there has been a fundamental change to our view of the investment thesis. In the case of PetMed Express, increased competition from Walmart and Amazon fundamentally changed our view of the company's competitive (price) advantages in the marketplace.



PetMed Express, increased competition from Walmart and Amazon fundamentally changed our view of the company's competitive (price) advantages in the marketplace.

In February, Bayer - the maker of the popular Advantage and K9 Advantix tick/flea control products, announced it would begin selling its blockbuster directly through retailers. Although this lowered product costs for PetMed, it also increased competition. While we felt PetMed would continue to take share away from veterinarians, consumers would shift towards even lower-priced options like Walmart. The increase in competition would challenge the company's revenue growth, and negatively impact profit margins as the company may have to increase advertising spending to maintain its existing revenue growth rate. In short, increased competition from lower-priced competitors called into question the long-term viability of PetMed's business model and we made a decision to reduce our exposure accordingly. ■

U.S. Value Portfolio Transactions

Portfolio Sales

Annaly Capital Management, Inc. (NLY)

Large-Cap, Financials

Annaly Capital Management (NLY) is a residential mortgage REIT that generates its income from a leveraged interest rate margin between the investment interest (mortgage securities) and its funding costs (repurchase market). Effectively NLY is an investment in a residential mortgage

bank without the operational or credit risk. We invested in NLY when in May 2009 fears of mass refinancing activity was overestimated, causing a value opportunity. After a one year holding period and a return of more than 20%, our outlook for a shrinking yield spread called for a sale of the investment. We sold the stock after a poor earnings report, rather than staying patient in this income yield vehicle until

the price returned to our original target sales price of \$18 per share.

j2 Global Communications (JCOM)

Small-Cap, Telecommunications

j2 Global Communications is a worldwide company providing communication services such as electronic fax, voicemail, email and call handling. In a routine review of the value portfolio we decided to sell the name

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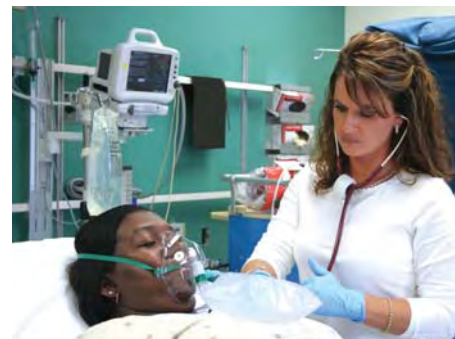
U.S. Value Portfolio Transactions (continued from 7)

for a short-term gain of approximately 10%. Our sell decision was based on a risk-adjusted target price being reached.

Lincare Holdings Inc. (LNCR)*Mid-Cap, Healthcare*

Lincare Holdings is one of the largest providers of oxygen equipment and respiratory therapy services in the United States. Medicare and Medicaid payments comprise two thirds of LNCR's revenues. In our opinion, the impact of changes in the Medicare system were overestimated when we invested in the stock in 2008.

We remained patient for a year before the stock performed well as a more favorable regulatory environment became apparent. In a routine review of the value portfolio we decided to sell LNCR based on our target price methodology for a long-term gain of almost 100%. Fortuitously for our clients and after our sale occurred, the Centers for Medicare and Medicaid Services announced reimbursement for oxygen supplies and equipment will be reduced by an average of 31%. The stock declined by 18% in the days after the announcement in early July 2010. ■



We decided to sell Lincare Holdings, one of the largest providers of oxygen equipment and respiratory therapy services in the U.S., based on our target price methodology for a long-term gain of almost 100%.

International Portfolio Transactions

Portfolio Sales**Banco Santander, S.A. (STD)***Large-Cap, Financials, Spain*

Our decision to sell Banco Santander (STD) was solely driven by the increased risk profile caused by the European debt crisis. We based our decision on the climb in Spain's sovereign credit default swaps even after support for the Greek aid package gained momentum in late April. Despite the bank's attractive positioning in growing Latin American markets, the exposure to the Spanish economy was an overwhelming risk. Our decision was vindicated as the

stock declined another 30% after our sale. Recently the stock price has returned to our sale level, but the credit default swaps for Spain have continued to climb, signaling high risk and keeping us from purchasing the stock again.

Telefonica, S.A. (TEF)*Large-Cap, Telecommunications, Spain*

We sold Telefonica to reduce our exposure to Spain, given the increased macroeconomic risks in that country. In addition to sovereign debt/budget issues and an unsustainably high unemployment

rate, we felt that a recent move by the Spanish telecom regulator to cut mobile termination rates by 40%-50% (which significantly lowered the growth ceiling in its Spanish operations) would materially impact the company's domestic operations. Coupled with weakness in its other European markets and a bidding war loss to rival Vivendi for GVT (a telecom carrier in Brazil, a high growth market for TEF), we became increasingly concerned about the Spanish telecom's ability to generate any positive revenue or earnings growth over the near- to medium-term. ■

Fixed Income Review

Market Review

Interest rates decreased during the quarter for both taxable and tax-free bonds. The U.S. Treasury yield curve decreased more than 80 basis points on the longer 10- and 30-year maturities and the shorter maturities saw decreases of half a percent in the two- and three-year range. Municipal yields also decreased, although to a much smaller degree. The 10-year AAA curve

While we think that credit is of paramount importance, we do not subscribe to the belief of some that there will be a systemic muni bond collapse.

decreased 30 basis points and 30-year AAA bonds decreased by only nine basis points. Lower quality municipal yields spreads tightened as those rates decreased by a larger extent.

Matterhorn's fixed income strategy for the last two years has been to emphasize high credit quality. This strategy is receiving ever increasing attention in the media as concerns for bonds as an investment class mount. These concerns are due to a historically low interest rate environment and the global economy's impact on credit worthiness. This is true in both the taxable and municipal markets.

Attention is being focused on the municipalities' budget challenges and their ability to meet their bond obligations. While we think that credit is of paramount importance, we do not subscribe to the belief of some that there will be a systemic muni bond collapse. We think opportunities still exist for investment, the credit and default problems will be isolated and that default risk can all but be eliminated with careful bond selection.

Portfolio Review

Matterhorn's municipal bond composite continues to show a (continued next page)

Fixed Income Review (continued from 8)

strong tax-free, yield-on-cost basis of 3.68%. Using a marginal tax rate of 35%, this yield is 5.66%, down only eight basis points from the previous quarter despite the decline in interest rates. The portfolio's duration-to-worst calculation is 3.65 compared to the benchmark of 3.89. While the yield is above the benchmark, the municipal bond composite underperformed its benchmark on a total return basis for the quarter. The composite had a total return of +1.47% compared to +1.81% for the Barclays 1-10 year Municipal Bond Index. As we have demonstrated in previous quarters, yield is our primary

strategy with a market neutral maturity structure. We believe this strategy produces more income to our clients rather than a total return focus.

For the next several quarters, we will continue our emphasis on high credit quality for both taxable and municipal credits. Our municipal focus will remain on general obligation and essential service revenue bonds and our geographic focus will be almost exclusively Texas. Our credit focus is almost exclusively AA and AAA underlying credit ratings and with the exception of Texas school district bonds backed by the Permanent School Fund

(PSF), we regard municipal bond insurance as a secondary credit support and do not rely on it in the same manner as the bond issuer's credit ratings.

In the past two quarters we have stated our strategy will remain market-neutral on duration with anticipated increases in the yield curve in the latter part of 2010. We have revised our interest rate outlook, but our neutral maturity strategy remains. We no longer look for a Fed-tightening scenario in 2010 and anticipate yields to remain range-bound for the remainder of 2010 and into 2011. ■

Compliance Corner

Clients are advised to notify their MCM representative of any changes to their financial status, including changes in income needs, account restrictions and/or risk tolerance. Clients are reminded to review their custodial statements with those received from Matterhorn Capital Management, LLC.

Please contact us if you do not receive a statement from your custodian.

The latest copy of our firm's Privacy Policy and ADV Part II can be found on our web site at www.matterhorncap.com.

If you have questions or concerns or would like a hard copy of the Privacy Policy or ADV Part II, please contact Neala Moore at (210) 694-4329 or Matterhorn Capital Management, LLC, 16410 Blanco Rd., Suite 2 San Antonio, TX 78232. ■

Value Portfolio

CONSUMER DISCRETIONARY 4.2%

Omnicom Group 10,492

CONSUMER STAPLES 9.1%PepsiCo 99,843
NBTY 2,173**ENERGY 15.4%**ConocoPhillips 72,957
NuStar Energy 3,685
Hugoton Royalty Trust 758**FINANCIALS 14.3%**AFLAC 20,412
Arch Capital Group 3,915
Cullen/Frost Bankers 3,073**HEALTHCARE 9.9%**Becton Dickinson 15,801
Humana 7,593**INDUSTRIALS 4.5%**

Hubbell 2,440

INFORMATION TECHNOLOGY 13.4%Microsoft 202,971
Accenture 27,474
Comtech Telecommunications 811**BASIC MATERIALS 5.7%**

Pactiv 2,321

TELECOMMUNICATION SVCS**UTILITIES 4.8%**

Duke Energy 21,126

CASH HOLDINGS 18.7%

Growth Portfolio

CONSUMER DISCRETIONARY 14.7%Nike 33,304
Gymboree 1,300
True Religion Apparel 570**CONSUMER STAPLES 5.3%**

Colgate Palmolive 38,741

ENERGY 14.4%Transocean 15,715
EOG Resources 25,189
Peabody Energy 10,681**FINANCIALS 4.5%**

Hudson City Bancorp 6,451

HEALTHCARE 4.2%

Amedisys 1,054

INDUSTRIALS 9.6%Fluor 7,446
Flir Systems 4,505**INFORMATION TECHNOLOGY 20.5%**Apple 226,120
Google 140,067
Activision Blizzard 13,086
Ebix 534**BASIC MATERIALS****TELECOMMUNICATION SVCS****UTILITIES****CASH HOLDINGS 26.8%**

International Portfolio

CONSUMER DISCRETIONARY**CONSUMER STAPLES 8.4%**Unilever 81,624
Coca Cola FEMSA 11,698**ENERGY 15.1%**BG Group 52,959
Canadian Natural Resources 36,278
Sasol 24,119**FINANCIALS 7.7%**Barclays 49,024
Bank of Nova Scotia 47,660**HEALTHCARE 13.3%**Novartis 127,002
AstraZeneca 67,806
Fresenius Med Care 16,205**INDUSTRIALS 6.8%**ABB 150,669
Elbit Systems 2,134**INFORMATION TECHNOLOGY 11.1%**Research in Motion 26,590
Check Point Software 6,066
AsiaInfo Holdings 1,025**BASIC MATERIALS 7.5%**Potash 25,238
Yanzhou Coal Mining 10,477**TELECOMMUNICATION SVCS 4.5%**

Chunghwa Telecom 19,578

UTILITIES 4.9%

CPFL Energia 11,010

CASH HOLDINGS 20.76%

Percentages = portfolio weightings. Dollar amounts = market capitalization in millions of each company.

Equity Portfolio Performance (Net of Fees)

Global All-Cap Core Equity Composite (as of 6/30/10)

	QTD	YTD	1 YR	3YR	5YR	ITD
Matterhorn Capital Global Core	(9.41)	(5.73)	12.47	(5.09)	2.43	3.28
Core Equity Blend Index	(12.22)	(8.72)	11.62	(11.82)	(1.27)	(0.79)
S&P 500 Index	(11.86)	(7.57)	12.11	(11.83)	(2.85)	(2.27)

Inception to date (4/14/2005), 3- and 5-year returns annualized.
Composite contains U.S. Growth, U.S. Value, International and Global Core accounts.
Blended index consists of two-thirds Russell 3000 Index and one-third MSCI World ex U.S. indices.
Index returns do not include dividend payments or reinvestment of dividends.

International Equity Composite (as of 6/30/10)

	QTD	YTD	1 YR	3YR	5YR	ITD
Matterhorn Capital International	(10.95)	(10.28)	7.64	(5.88)		0.46
MSCI World ex U.S. Index	(13.31)	(12.42)	7.71	(13.08)		(5.61)

Inception to date (9/30/2006) and 3-year returns annualized.
Index returns do not include dividend payments or reinvestment of dividends.

Fixed Income Portfolio Performance (Net of Fees)

Municipal Bond Composite (as of 6/30/10)

	QTD	YTD	1 YR	3YR	5YR	ITD
Matterhorn Capital Municipal Bond	1.48	1.79	4.65	4.98		4.27
Barclays 1-10 Year Municipal Bond	1.81	2.68	6.63	6.10		5.23

Inception to date (9/30/2006), 2-year and 3-year returns annualized.

Muni Bond Composite Portfolio Characteristics

As of 06/30/10	MCM	Barclays 1-10 Muni Blend
Weighted Average Coupon	4.73	4.97
Duration to Worst	3.65	3.89
Yield to Worst	1.99	2.23
TE Yield to Worst	3.06	3.43



Matterhorn Capital Management, LLC ("MCM") is an independent investment management firm that invests client portfolios predominantly in U.S. traded equities and bonds creating either a large to small-capitalization equity portfolio in the growth, value or core investment styles or an investment grade domestic fixed income portfolio of taxable, tax-free or a blend of taxable and tax-free securities. Returns are calculated net of fees, including advisory fees, custody fees, brokerage commissions, and include reinvestment of all income. Returns are presented net of nonreclaimable withholding taxes. Past performance is not indicative of future results. There is a possibility of loss. Returns are calculated by Advent Axys and reflect the total account return, inclusive of securities, cash and accrued income.

The portfolio characteristics shown relate to the investment strategy as indicated by the composite title. Not every client's account will have these exact characteristics. The actual characteristics with respect to any particular client account will vary based on a number of factors including but not limited to: 1) the size of the account; 2) investment restrictions applicable to the account, if any; and 3) market exigencies at the time of investment. Net of fees performance returns are calculated by deducting the fee from the individual accounts. The annual management fee schedule for equities is as follows: 1% on first \$0-\$2MM; 0.90% on next \$3MM; 0.80% on next \$5MM; and 0.70% above \$10MM. The annual management fee schedule for fixed income is as follows: 0.40% on first \$0-\$5MM; 0.35% on next \$5MM; 0.30% above \$10MM. Be advised that fees are negotiable and that clients receiving the same service may be paying different fees based upon various factors including but not limited to: account size, number of accounts, complexity, relationship and nature of the account (direct vs. sub-advised).

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MCM calculates performance by following the Global Investment Performance Presentation Standards (GIPS®). The listed composites contain all fee-paying accounts with an investment strategy as indicated by the composite title. These portfolios are managed in a tax-aware manner. Non-fee paying or non-discretionary portfolios are excluded from the composites but are included in the definition of total firm assets. Neither leverage nor derivatives are used in the composite portfolios. Performance results are expressed in U.S. dollars. Performance returns are considered PRELIMINARY numbers until verified according to GIPS® for the reporting period. To receive a complete list and description of MCM composites and a presentation that adheres to the GIPS standards, contact Stefan Gräter at (210) 694-4329 or write Matterhorn Capital Management, LLC, 16410 Blanco Rd., Suite 2, San Antonio, TX 78323 or sgrater@matterhorncap.com.