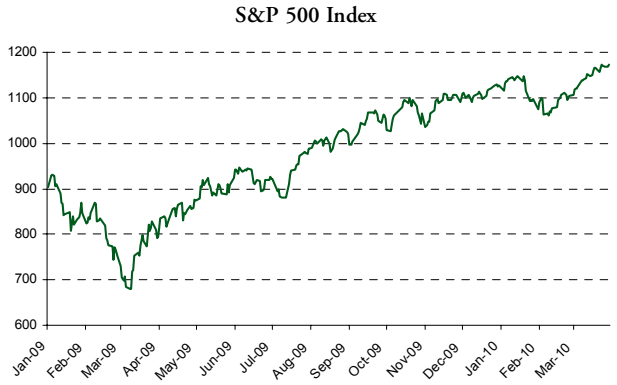
CEDAR HILL
WEALTH MANAGEMENT

Quarterly Investment Review

March 31, 2010

Financial Review

U.S. equity markets continued to sail higher in the first quarter of 2010, extending the remarkable market recovery that began in March of 2009. Despite a modest pullback in January, the S&P 500 caught another gust of wind in February and March that helped the index deliver a 5.4% return for the quarter. While fears began to mount during the quarter over the systemic impact Greece's debt crisis could have on the Euro-zone and the global economy, investors were able to largely shake off those concerns (for now).



No one would argue that the market recovery has been impressively fast and steep (up roughly 75% from the March 2009 low). Greater debate continues to swarm, however, as to whether the recovery has been *too* fast and *too* steep. Given that the world was teetering on the edges of an economic abyss in early 2009 and equities were being priced at extremely low valuations (reflecting in some cases a high probability of bankruptcy), the sharp correction in stock prices over the past year appears merited given today's drastically improved economic setting. The larger question is whether future fiscal policy and economic conditions will continue to create the supportive environment necessary for the financial markets to sustain the recovery.

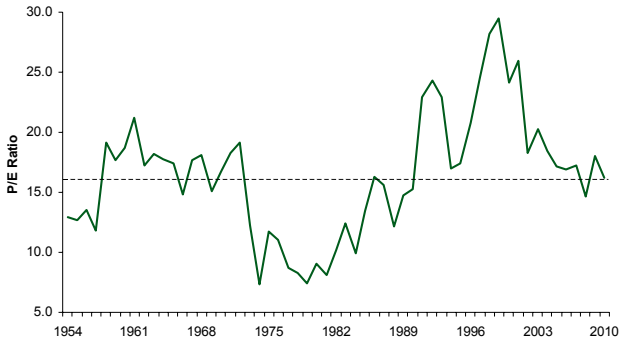
Though relatively positive, we are not Pollyannaish about the current market environment. One of our more pressing concerns is the pervasive use of leverage (debt) that remains in the system. While financial overextension in the private sector ignited the financial crisis, the public sector appears to be replicating that same failed course of action. The ballooning of sovereign balance sheets could have a significant long-term impact on the trajectory and sustainability of an economic recovery. There is no question that the epic fiscal and monetary support policies enacted (both domestically and abroad) following the bankruptcy of Lehman Brothers helped to curtail a near-collapse in the global financial markets. Nonetheless, this government-induced stability came at a significant cost. Many of the world's developed nations (including the U.S.) now face massive budget deficits, so a protracted deleveraging process will be needed over the coming years. In the U.S., state and municipal balance sheets are in disarray and an already bloated federal deficit is likely to be compounded by healthcare reform that will necessitate additional government spending ($900 billion over ten years according to the Congressional Budget Office). Given the precarious financial position the public sector is currently in, tax increases (for both individuals and corporations) seem inevitable.

Higher taxes coupled with the requisite deleveraging of the public and private sectors could suppress economic growth below pre-crisis growth rates for some time.

Economic expansion may prove more modest in the "new normal" environment, but we remain constructive about the long-term outlook for the economy. With a few notable exceptions, economic data remains encouraging and continues to point toward a sustainable recovery. GDP grew at its fastest pace (5.6%) in 6 years during the fourth quarter of 2009, consumer spending has risen for five straight months, manufacturing activity has expanded for eight straight months, and corporate profitability is surging (albeit from depressed levels). All of this has occurred with a still elevated unemployment rate (9.7%). With the economy seemingly progressing to an inflection point where it will start creating jobs again and returning more workers to the labor force, we should see continued economic improvement. While there are concerns about how the economy will respond as government starts to rein in some of its monetary and fiscal stimuli in the coming months, it should also be noted that the benefits of those previously enacted policies are still reverberating through the economy and could continue to do so over the next several quarters due to the lag effect of these programs. And, as corporate profitability expands and corporations hire back employees, private sector growth could be able to more than offset the gap left by sunsetting stimulus programs.

With the S&P closing out the quarter near its highest levels in 18 months, the markets appear to share some of our optimism about the long-term prospects for the economy. As we noted in our last quarterly letter, we wouldn't be surprised to see a temporary pullback in the equity markets at some point in 2010 given the near-parabolic rise in stock prices over the last year. That said, we continue to believe the market is poised for continued long-term expansion. From a price-to-earnings standpoint, the market looks fairly valued at current prices. At the end of the quarter, the S&P 500 was trading at a 16.1x price-to-earnings multiple, in line with the average P/E multiple (16.4x) that the market has traded at over the last 55 years. Assuming market valuation multiples remain relatively constant at these reasonable levels, an increase in corporate profitability over the coming years should drive a corresponding increase in equity prices.

S&P 500 Valuation History



Given the number of challenges the global economy continues to face, the investment environment could become a bit choppier than the market's rather unabated recovery over the last 13 months. But with the worst of the economic crisis seemingly behind us, the market is clearly tacked in the right direction.

Core Equity Portfolio

During the first quarter, we initiated positions in Amgen and Lockheed Martin, while eliminating our position in Honeywell.

Amgen (AMGN) is the world's largest independent biotechnology firm. The company primarily develops biologic therapies for oncology and inflammation. Amgen currently markets five core multibillion-dollar products, but its future growth will be highly correlated to the success of Denosumab – a Phase III drug for osteoporosis, metastatic bone disease, and hormone-related bone loss in breast and prostate cancer patients. While biotech companies like Amgen once fetched stratospheric valuations of 60 times earnings (or more) during the biotech frenzy of the late-90s and early-2000s, we purchased the company at a reasonable 12 times 2010 earnings. Sentiment surrounding the biotechnology sector has been negatively impacted by concerns over generic competition and uncertainties surrounding healthcare reform. Believing many of these concerns have been overstated, we viewed this as an attractive buying opportunity. We expect to continue to look for other enticing opportunities in the healthcare space.

Lockheed Martin (LMT) is a leading defense contractor and the manufacturer of military jetfighters such as the F-35, F-22, and F-16, as well as other defense systems platforms. Total defense spending is expected to face increased scrutiny in the coming years and grow at a significantly lower level than the accelerated growth rates recorded over the last several years. While Lockheed won't emerge unscathed from the reallocations and cuts in government spending, the company remains extremely well positioned for growth due to the overwhelming support its F-35 platform has received. The U.S. government plans to purchase 2,443 of these jetfighters over the life of the F-35 program. This represents a $300 billion revenue opportunity for the firm in procurement sales alone – plus an additional $700 billion of maintenance and service revenue potential over the lifetime of the program. As a result, we believe the F-35 program will deliver consistent cash generation and material earnings growth over the coming years. This should ultimately translate into attractive shareholder returns.

In conjunction with our purchase of Lockheed Martin, we sold our position in Honeywell (HON). Honeywell was purchased during October 2008, in the midst of the economic slowdown, as we believed management had strategically positioned the company for such an event through three years of restructuring its business portfolio. The company (and shareholders) benefited from the effort, as operating earnings held up relatively well in the difficult market. While we continued to view Honeywell as a well-run company, we believed the shares were fully valued and saw greater return potential in Lockheed Martin at the prevailing market prices.

Fixed Income Markets

After shifting modestly lower during most of the first quarter, the U.S. treasury yield curve finished the quarter relatively unchanged. Early in the quarter, demand for U.S. treasuries was robust, in part due to continuing weakness in unemployment and concerns of the recovery hitting a plateau – or perhaps the possibility of a "double-dip" recession. In March, however, economic data indicated the recovery remained on solid footing, causing some investors to shift assets from low-yielding treasuries toward higher-return (and higher-risk) asset classes. In addition, the passage of healthcare reform legislation reinforced concerns over growing unsustainable deficits. As the government continued to fund these deficits with increasing levels of debt, auctions of treasury

securities performed poorly, as previously strong demand waned. This is likely the first warning shot for a sustained rise in long-term interest rates as investors – both domestic and foreign (i.e., China) – become less comfortable with financing the federal government's balance sheet.

Corporate bonds are modestly attractive compared with treasuries. For tax-free investments, yields on short to intermediate duration municipal bonds remain more attractive on a risk-adjusted basis than stretching for slightly higher yields with longer duration bonds.

Alternative Investments

A diverse array of asset classes delivered strong returns during the quarter, with increased risk appetite shown by the sell-off in "safe havens" of gold and treasuries. **Event Driven** and **Credit** continued their rally that started over a year ago. Refinancing was the theme of the quarter as a record amount of high yield bonds were issued. With over $1.1 trillion in high yield bonds and leveraged loans maturing between now and 2014, companies are proactive in solving looming balance sheet issues prior to debt maturities. Preemptive recapitalizations (loan-for-bond, loan-for-equity, or bond-for-equity exchanges) are expected to keep the new issue market robust. Even with this new supply, credit spreads (the difference between the yield on high yield corporate debt and similar maturity U.S. treasury bonds) narrowed from 6.5% to 5.8%.

As expected, **Equity Long/Short** underperformed a strong market rally, but outperformed the equity indices on a net market exposure basis. Good stock picking – along with tactically increasing exposure levels during the latter half of the quarter as the market rallied – drove performance. Emerging market Long/Short managers outperformed their U.S. counterparts as a result of their propensity for higher net market exposure levels.

After underperforming other emerging markets in 2009, Middle Eastern markets got off to an excellent start, benefiting from the announced restructuring plan for Dubai's world debt.

Private Equity and **Real Estate** activity continues to be constrained. Reasons for the subdued environment remain: a) unavailability of credit, b) wide bid/ask spreads, c) concerns over the potential wave of defaults, and d) declining real estate asset valuations. Banks have only marginally increased credit availability. Until lenders lend, we expect **Private Equity** and **Real Estate** firms to be more focused on maximizing cash flows on current investments rather than striking new deals.

Final Note

We are pleased to report that Cedar Hill's Large Cap Core Equity strategy earned the "Manager of the Decade" designation from PSN/Informa Investment Solutions, a leading investment manager database provider. The PSN database contains quantitative and qualitative investment manager data from almost 2,000 investment advisors covering over 10,000 products. The PSN database is used by investment consultants, plan sponsors, and financial advisors searching for investment managers.

The "Manager of the Decade" designation was given to the top 10 managers for each investment category (in our case Large Cap Core Equity) based on 10-year investment performance and risk measurement (standard deviation). Cedar Hill ranked in the top 1% out of a universe of 431 large cap core products managed by 272 managers for the 10-year period ending December 31, 2009.

One Year Economic Overview

		Mar 2010	Mar 2009
Stock Market			
S&P 500 Index	▲	1,169.43	797.87
Russell 2000 Index	▲	678.64	422.75
Fixed Income Yields			
3-Month Treasuries	▼	0.15%	0.23%
5-Year Treasuries	▲	2.55	1.66
10-Year Treasuries	▲	3.84	2.70
30-Year Treasuries	▲	4.71	3.54
Inflation Monitor			
CPI-Trailing 12-Month Growth	▲	2.4%	-0.1%
CPI-(Excluding Food/Energy)	▼	1.2	1.7
Market Expectations*	▶	1.3	1.3
Gold (per ounce)	▲	$1,113.25	$919.15
Crude Oil (per barrel)	▲	83.76	49.66

*Comparison of yields for 10-Year Treasury and 10-Year TIPs