



"It's only when the tide goes out that you find out who's been swimming naked" (Warren Buffet)

The Market: High Quality vs. Low Quality

- 2nd half of 2009 saw a return to mechanical, directional trading irrespective of fundamentals.
- Investors rushed back into the broad market (the index) in the second half of '09 in an effort to participate in the bull rally.
- Highly levered companies found new life as equity investors flocked to the largest, most liquid names in small cap growth. Thinking being that they can participate in rally on the way up, and get out easily if things turned negative.
- As prices of lower quality names continued their strength, their weighting in the index became larger, thus the self-fulfilling nature of their continued performance.
- The best performing groups within the index in the second half of '09 were companies with the highest amount of financial leverage. (See Tables Below) Many of these "low quality" companies are low on cash reserves and have unpredictable business operations that are either unprofitable or only marginally profitable.

1st HALF 2009

	<u>TOTAL AVE RETURN</u>	<u>AVE DEBT</u>	<u>AVE MKT CAP</u>	<u>DEBT TO MKT CAP</u>
1 st QUINTILE	18.75%	\$775	\$696	111.26%
2 nd QUINTILE	28.36%	\$166	\$580	28.65%
3 rd QUINTILE	22.13%	\$37	\$432	8.59%
4 th QUINTILE	24.90%	\$3	\$630	0.42%
5 th QUINTILE	22.75%	\$0	\$297	0.00%

2nd HALF 2009

	<u>TOTAL AVE RETURN</u>	<u>AVE DEBT</u>	<u>AVE MKT CAP</u>	<u>DEBT TO MKT CAP</u>
1 st QUINTILE	37.19%	\$838	\$838	100.00%
2 nd QUINTILE	20.75%	\$129	\$664	19.00%
3 rd QUINTILE	15.38%	\$22	\$447	5.00%
4 th QUINTILE	17.60%	\$1	\$489	0.00%
5 th QUINTILE	15.9%	\$0	\$499	0.00%

4th QUARTER 2009

	<u>TOTAL AVE RETURN</u>	<u>AVE DEBT</u>	<u>AVE MKT CAP</u>	<u>DEBT TO MKT CAP</u>
1 st QUINTILE	4.23%	\$841	\$834	101.00%
2 nd QUINTILE	2.73%	\$130	\$669	19.00%
3 rd QUINTILE	0.67%	\$22	\$447	5.00%
4 th QUINTILE	1.32%	\$1	\$489	0.00%
5 th QUINTILE	-0.15%	\$0	\$498	0.00%

Source: Thomson Baseline

PERFORMANCE

- Underweight stance toward the U.S. Consumer Sector hampered our performance in Q4 and the year.
- Economic data doesn't appear to support a strong consumer sector... "Most Districts reported that consumer spending in the recent 2009 holiday season was slightly greater than in 2008, but still far below the 2007 level". (*Federal Reserve Beige Book*)
- Many stocks within the consumer discretionary sector are trading at pre-crisis levels. At current unemployment rates, these valuations are not supported or sustainable over the near term in our view.
- The Health Care Sector was our other significant under-performer in 2009. Uncertainty over pending reform legislation has made it extremely difficult to discriminate winners from losers in this sector over the short term.

OUTLOOK

Over the past few months, we have become increasingly concerned about the overall health of the economy and the underlying foundation of the recent stock market recovery. We are positioning the portfolio in line with what we're hearing from companies and their end markets rather than how the stock market is acting. Throughout many industries we continue to believe there is a disconnect between the current state of business, near-term growth prospects and where many stocks are priced.

As we discussed throughout the year, we believe there is a new definition for "NORMAL" in this credit constrained world, and believe it will not prove good for all companies. We believe the high-quality cash rich growth companies will thrive over the long-term, and the low-quality, debt-laden companies will struggle and downsize in such an environment. These companies may outperform over short periods of time like the one we've just witnessed, when investors urge is driven more by their own liquidity needs than the fundamentals of the individual companies they are investing. Many of these "low quality" companies performed well early in 2009 as investors determined that they wouldn't go out of business and bid them up from overly depressed prices. But why did their stock prices continue to go up late into the year? The general answer we received from many of the large trading desks and others in the industry was, "We're seeing buying in mostly liquid names. Portfolio managers are seeing in-flows of capital and are gravitating to companies whose stocks trade volume." The reason being, "in case something goes wrong, we can get out!" Large debt loads generally equal larger market capitalizations and more "investor liquidity". However, we believe that once investors see the real results of these "low quality" companies, it will be the "sell on the news" scenario with anything but stellar performance serving as a catalyst for profit taking.

In this "New Normal" environment, investors are searching for ways to express and measure certain immeasurable things, such as risk. Our belief is that "Risk" is and always will be the risk of permanent loss. And that "Reward" is the return to shareholders once the business plan has been fully executed. A trend over the past few years has been to define and quantify risk by a stock's inclusion and weight within a particular index. The rationale being, "go where the money goes" (with the herd in ETFs and Index Funds) and if I'm wrong, I'll be wrong right along with everyone else. Well, in our opinion, there's nothing rational, active or fundamental about this kind of investing. And it's certainly not what our clients pay us to do.

We have identified several very visible themes taking shape in 2010, including inventory replenishment, increased government spending to combat unemployment, bandwidth constraints as the technology revolution continues, and green energy incentives including smart grid deployments. With the nature of the small cap sector, and our strategy in particular, we don't look to own companies doing the mining but rather the ones that are supplying the miners with critical products and services.

In the near term, the markets may continue to trend higher in the face of a much slower recovery. We believe liquidity continues to drive this market on a daily basis. We believe that the valuations for the companies still dealing with an over-leveraged capital structure are way ahead of themselves in this environment of tighter credit, higher risk premiums and higher expenses related to their capital structure. We will continue to own and buy companies where the disconnect between underlying fundamentals and stock prices is firmly in our favor, and avoid companies where current stock prices are unsupported even when they are a large component of our relative benchmark.

As we look forward, we continue believe with great conviction that over the long run the market will discriminate between companies that execute their fundamental business strategy, and ones hoping to get bailed out by a big cyclical recovery. We will remain diligent in finding (and owning) the companies that are, to a large extent, in control of their own destiny. We believe that the valuations of the companies in our portfolio are extremely attractive and despite the recent rally, still have substantial appreciation potential in spite of the difficult environment we foresee ahead. The road along the way will continue to encounter bumps, and these bumps will allow us the opportunity to position for the next leg.

As always, we assure you that our focus is singular and our efforts vigilant. Thank you for your continued support.

Ryan Carr



Chief Investment Officer

U.S. SMALL CAP GROWTH EQUITY DISCLOSURE

Sparta Asset Management, LLC (SAM) US Small Cap Growth Equity Composite consists of fully discretionary equity portfolios seeking to achieve long-term capital appreciation by identifying securities of small-capitalization growth companies with the potential for significant long-term price appreciation. The composite is measured against the Russell 2000 Growth Index. The minimum account size for inclusion in the composite is currently \$5,000,000. From September 17, 2007 through September 30, 2008 the minimum account size was \$250,000. From July 1, 2005 through September 14, 2007 the minimum account size was \$1,000,000. Prior to July 1, 2005 the minimum account size was \$100,000.

Sparta Asset Management, LLC has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

Sparta Asset Management, LLC is a registered investment advisor. The firm maintains a complete list and description of composites, which is available upon request.

Sparta Asset Management, LLC has been GIPS verified for the periods September 17, 2007 through September 30, 2009 by Ashland Partners & Company LLP. A copy of the verification report is available upon request. In addition, a composite specific performance examination has been conducted on the US Small Cap Growth Equity Composite beginning September 17, 2007. The period October 1, 1995 through September 14, 2007 represents the equity portfolio track record established by the Portfolio Manager while affiliated with a prior firm. Ashland has reviewed this track record for compliance with the portability requirements of GIPS standards.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results. Inherent in any investment is the potential for loss.

The US Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. From 7/1/07 to present, net of fee performance was calculated using highest management fee of 1.00%. Prior to July 1, 2007 net of fee performance was calculated using actual management fees. Prior to July 1, 2005, the composite was comprised of 100% bundled fee accounts and net of fee returns during this period are net of all fees. The bundled fee includes all advisory, trading, custody, and administrative fees charged to the portfolios. The annual composite dispersion presented for years 2000 – 2004 is an equal-weighted standard deviation calculated for the accounts in the composite the entire year. The annual composite dispersion for year 2009 going forward is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Additional information regarding the policies for calculating and reporting returns is available upon request.

The management fee schedule is as follows: 1.00% on first \$25 million; 0.85% on next \$25 million; 0.80% on next \$50 million; and 0.75% on assets over \$100 million. Each client's returns will be reduced by the advisory fee and any other expenses incurred in the management of the investment advisory account. Actual investment advisory fees incurred by clients may vary.

The US Small Cap Growth Equity Composite was created on September 17, 2007. All performance shown prior to September 17, 2007 is that of the Small Cap Growth Equity portfolio composite managed at a prior firm. The Portfolio Manager was the only individual responsible for selecting the securities to buy and sell. Performance shown from the prior firm does not necessarily indicate how the US Small Cap Growth Equity Composite will perform in the future.

This performance information gives some indication of the risks of an investment in the US Small Cap Growth Equity Composite. Performance figures for the period ended shown herein represent a composite of fully discretionary, fee-paying SAM equity accounts above \$5,000,000. The composite is size weighted and includes terminated accounts through their last full month under management. The returns presented reflect the reinvestment of dividends and other earnings. Beginning September 17, 2007, composite policy requires the temporary removal of any portfolio incurring a client-initiated significant cash inflow or outflow of 10% or more of portfolio assets. This will cause the account to be removed for the month in which the large inflow or outflow occurred. The account will be re-included in the composite the month following the large inflow or outflow. Sparta Asset Management, LLC will document the date of the cash inflow or outflow, date the account is removed, and date the account is re-included. Sparta Asset Management, LLC will also document the amount of the inflow and outflow and identify if it is a contribution or withdrawal from the portfolio. Additional information regarding the treatment of significant cash flows is available upon request. There is no guarantee that the portfolio manager will achieve similar results in the future. Please refer to the Sparta Asset Management, LLC Form ADV Part II for a full disclosure of the fee schedule and other detailed information regarding the services offered. The returns presented have sustained significant gains and losses due to market volatility.

Index Information

The Russell 2000 Index is a market value weighted index of the 2000 smallest US companies in the Russell 3000 Index, which includes 3000 of the biggest US stocks. The Russell 2000 Growth Index consists of those Russell 2000 companies with higher price-to-book and higher forecasted growth values. The volatility of the indices may be materially different from the individual performance attained by a specific investor. In addition, Adviser's holdings may differ significantly from the securities that comprise the indices. The indices have not been selected to represent an appropriate benchmark to compare an investor's performance, but rather are disclosed to allow for comparison of the investor's performance to that of certain well-known and widely recognized indices. You cannot invest directly in an index.

COMPOSITE PERFORMANCE

YEAR END	COMPOSITE ASSETS (USD)		ANNUAL PERFORMANCE RESULTS				
	TOTAL FIRM ASSETS (THOUSANDS)	COMPOSITE ASSETS (THOUSANDS)	NUMBER OF ACCOUNTS	COMPOSITE GROSS	COMPOSITE NET	RUSSELL 2000 GROWTH	COMPOSITE DISPERSION
2009	441,668	228,833	10	34.45%	33.18%	34.47%	0.34%
2008	226,053	171,246	9	(38.75%)	(39.45%)	(38.54%)	n.a.
2007	166,885	90,195	five or fewer	3.00%	2.03%	7.05%	n.a.
2006	n.a.*	74,211	five or fewer	14.96%	13.98%	13.35%	n.a.
2005	n.a.*	1,251	five or fewer	10.73%	9.63%	4.15%	n.a.
2004	n.a.*	11,160	43	18.41%	16.81%	14.31%	0.43%
2003	n.a.*	6,159	24	55.71%	53.44%	48.54%	0.96%
2002	n.a.*	2,639	12	(12.51%)	(14.04%)	(30.26%)	0.66%
2001	n.a.*	3,388	15	(5.68%)	(7.33%)	(9.23%)	0.96%
2000	n.a.*	4,011	20	11.21%	9.40%	(22.43%)	3.94%
1999	n.a.*	2,807	12	74.75%	72.18%	43.09%	n.a.
1998	n.a.*	941	five or fewer	(3.75%)	(5.40%)	1.23%	n.a.
1997	n.a.*	742	five or fewer	22.89%	20.76%	12.95%	n.a.
1996	n.a.*	245	five or fewer	31.38%	29.09%	11.26%	n.a.
1995 ⁺	n.a.*	108	five or fewer	(0.46%)	(0.92%)	1.48%	n.a.

⁺ 1995 represents a partial year beginning 10/1/1995 and ending 12/31/1995.

n.a.* Total firm assets were from a prior firm. See important disclosures about this performance information herein.

n.a. - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

