

General Market Commentary for the First Quarter of 2010

U.S. equity markets delivered an impressive quarter to start the New Year. This past quarter the US economy likely grew at over 2 percent, as corporate profits widely surpassed expectations, employment trends seemingly have turned positive, and housing prices continued to stabilize. Virtually every market index has now gained in excess of 75% since the lows from the spring of 2009, with the Russell 2000[®] Index (the benchmark for the portfolio) nearly doubling during this time period.

Small capitalization stocks outperformed large caps as the Russell 2000[®] Index returned 8.85%, as compared to the 5.7% return of the large company Russell 1000[®] Index. Value stocks, which had substantially larger exposure to the outperforming Financials sector, outperformed growth stocks as the Russell 2000[®] Value Index returned 10.02% outpacing the Russell 2000[®] Growth Index with a return of 7.61%.

We foresee the balance of 2010 as a skirmish between market bulls and bears. The result of such a battle will, on the surface, appear to be a period of moderate stock returns. Further analysis will reveal the wide divergence of individual stock price performance. There will be winners and there will be losers. Skillful equity managers, who utilize and adhere to an investment process focused on unearthing unique and insightful investment opportunities, will be rewarded. It is our continued expectation that this market backdrop will aid our team in delivering positive client outcomes.

Portfolio Commentary

For the quarter ending March 31, 2010, the portfolio outperformed the benchmark, the Russell 2000[®] Index. During the quarter, the largest positive contributors to performance were the portfolio's stock selection in the Energy, Health Care and Information Technology sectors. The strong performance from Energy was led by the persistent rise in the stock of Kodiak Oil & Gas Corporation. The Company continues to realize favorable drilling results from the acreage it owns in the Bakken Shale. Within Health Care, the stock of Nektar Therapeutics continued to outperform as the Company made several positive announcements concerning drugs under development. The Company possesses a unique drug delivery platform that is being applied to numerous indications, including several types of cancers. Additionally, the stock of Parexel International, a contract research organization providing drug development services, performed well as the Company announced solid earnings and improving order flow. Radiant Systems, Inc., a software provider to the hospitality market, was a top contributor within the Information Technology sector. The Company reported strong operating results due to market share gains and improved spending within the restaurant industry.

The portfolio's largest detractors to performance during the quarter were stock selection within the Consumer Discretionary and Consumer Staples sectors. We initiated a small position in Nutrisystem, Inc., a provider of weight loss programs, as we perceived the stock's 40% decline from a recent peak to be overly punitive with potential for the sales outlook to surprise to the upside. Our timing has, thus far, proved to be incorrect as the Company reported that new retail locations are slow in gaining sales traction. Although the investment performance on an absolute basis (down 15%) was not too severe, the investment suffered greater relative underperformance when compared to the index-leading return generated by the Consumer Discretionary sector of nearly 18%. Within Consumer Staples, the stock of Imperial Sugar struggled as reported results were clouded by the timing of insurance proceeds and derivative contracts used to hedge raw material prices.

At the end of the first quarter, the portfolio's three largest investments were in Kodiak Oil & Gas Corp., Fifth Street Finance Corp., and Radian Group, Inc. Kodiak is experiencing strong production growth from existing oil wells and the Company's reserve acreage at the Bakken Shale continues to deliver promising initial drilling indications. The stock's gain of greater than 50% was a strong contributor to the portfolio's performance during the quarter. Fifth Street Finance provides financing to small private companies that have potential for strong growth. The stock performed in-line with the strong results obtained from the Financials sector. Radian Group, Inc. provides financial guarantee services on home mortgages. Against a backdrop of improving fundamentals and perception of the mortgage industry, the stock more than doubled during the quarter. The investment in Radian was also the largest contributor to the portfolio's performance during the quarter.

Research Efforts

We continue to concentrate our research efforts on identifying companies that are attractively valued relative to their fundamental outlook. Given the market's strong advance, particular due diligence is required to determine if the anticipated operational improvements are already priced into a company's stock. As the economic recovery progresses, it is imperative that our companies achieve, or surpass, anticipated sales levels. With these factors in mind, we will be monitoring our existing (and potential) investments to ensure that the portfolio is best positioned to generate solid returns.

Sector or Industry Shifts

As the quarter progressed, we identified several attractive investment opportunities within the Energy sector which increased our relative sector positioning from a slight underweight to an overweight position as of the end of the quarter. We also reduced holdings within the Utilities sector as we perceived valuations to be unattractive when compared to the challenging fundamental outlook. No other significant sector shifts occurred and at the end of the quarter, the portfolio's largest overweight and underweight positions remained in the Financials and Health Care sectors, respectively.

Past performance is no guarantee of future results. The value of investments may go down as well as up and investors may not get back their original investment. Performance is shown gross of fees and charges. The opinions expressed herein are those of

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The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.