Quarterly NEWSLETTER
Fall 2010

Commonwealth Bank & Trust Company

4350 Brownsboro Road, Suite 210 • Louisville, KY 40207
502.259.2500 • www.CBandT.com

Heightened investor frustration is certainly understandable given the continued mixed bag of economic news and uncertainty concerning future fiscal, monetary and tax policies. While the latest boom/bust cycle has been more severe than most, our view is that investors should take advantage of these uncertain conditions by improving their approach to asset allocation and security selection. We believe opportunities exist in this environment to reduce risk and enhance returns by incorporating a more globally diverse allocation approach and selectively utilizing alternative fixed income and equity strategies to achieve optimal portfolio structures. We invite you to catch up on our latest thinking on these matters in this fall issue of our newsletter.

Commonwealth is a privately owned community bank offering a full complement of financial services including: Personal and Business Banking, Mortgages, Private Banking, Trust and Wealth Management. We are always looking for ways in which we can better serve our current clients and prospects and we encourage you to contact us for details on these and any of our other banking services.

- Mark J. Kennedy, Executive VP
p 502.259.2517
e mark.kennedy@cbandt.com

UNCERTAINTY PREVAILS

During the third quarter, the markets once again took investors on a roller coaster ride propelled by a multitude of mixed headlines and economic data. A July bounce preceded a disappointing August, which saw equity markets plunge despite solid earnings and positive merger news, followed by the best September since 1939; caused investors to grow weary with the uncertainty of it all. The Dow Jones Industrial Average was up 7.85% for September and 10.37% for the quarter while the S&P 500 gained 8.92% in September and 11.30% during the quarter. The September gains moved both indices back into the black for 2010, with the Dow up 3.45% and the S&P up 3.91% year-to-date. The gains were broad-based, with all the major markets experiencing impressive returns for the month. International markets also rallied after the August slump, with most major markets again looking past mediocre economic data. The MSCI EAFE gained 9.80% for September and 16.57% for the quarter. Investors increasing predilection for risk was evident in the emerging markets, which were up 10.87% for the month and 17.16% for the quarter.

Chart 1

Q3 – 2010
Market Performance - Total Returns

	9.30.10 Level	Q3	Year to Date
Dow Jones	10788	10.37%	3.45%
S&P 500	1141	11.30%	3.91%
NASDAQ Composite	2368	12.62%	5.17%
Russell 2000	676	11.29%	9.13%
S&P Midcap	802	13.11%	11.58%
Russell 1000 Growth	515	13.01%	4.38%
Russell 1000 Value	581	10.13%	4.51%
MSCI EAFE	1561	16.57%	1.64%
	Yield	Q3	Year-to-Date
Barclays Municipal	3.01%	3.40%	6.83%
Barclays Aggregate	2.56%	2.48%	7.94%
Barclays High Yield	7.80%	6.71%	11.53%

It was announced during the quarter that the recession officially ended in June 2009, but many still may not feel much relief. Although investor optimism increased recently due to receding fears of a double-dip recession and high expectations for solid earnings growth in the near future, worries remain. Unemployment remains at 9.6% and employers still seem hesitant to hire new workers. In addition, the housing market, which many believe has finally reached a bottom, has seen little improvement. On the other hand, GDP, while not stellar, will prove sufficiently positive to avoid a "double-dip". The Federal Reserve has been a major catalyst for this recovery and Chairman Ben Bernanke's recent announcement that he is prepared to engage in a second round of quantitative easing if conditions warrant was greeted favorably by both equity and fixed income markets. Investors are hoping that the combination of QE2 and the upcoming election results will serve as a catalyst for the markets through year end.

Chart 2

Q3 – 2010
S&P 500 Sector Performance

	Q3	Year-to-Date
Telecommunication	20.84%	10.85%
Utilities	12.34%	4.34%
Healthcare	8.86%	-0.69%
Consumer Staples	10.62%	7.55%
Energy	12.97%	-0.80%
Consumer Discretionary	15.17%	13.38%
Industrials	14.32%	13.36%
Information Technology	11.79%	-0.03%
Materials	17.83%	2.68%
Financials	4.34%	0.52%

Performance Results

	Managed Equity Composite 1,4	Small Cap Composite 2,5	Multi Cap Composite 3,6	S&P 500	S&P Mid Cap	S&P Small Cap7
Third Quarter	10.83%	9.07%	4.45%	11.30%	13.12%	9.62%
One Year	9.94%	7.30%	10.22%	10.16%	17.78%	14.22%
Three Year	-6.13%	-5.82%	-5.27%	-7.16%	-1.67%	-4.18%
Five Year	1.22%	2.81%	-0.36%	0.63%	3.77%	1.62%
Since Inception[4]	8.41%	N/A	N/A	7.57%	10.95%	N/A
Since Inception[5]	N/A	8.07%	N/A	1.14%	7.61%	7.19%
Since Inception[6]	N/A	N/A	7.70%	8.51%	12.17%	N/A

There is no assurance that any of these investment strategies will meet its investment objective. Performance results for each strategy are computed on the strategy's overall returns. Each strategy and index includes the reinvestment of dividends. Past performance does not guarantee future results. Current performance may be lower or higher than the performance results quoted. [1] Gross of management fees; performance results of CB&T; actual performance results would have been lower as a result of investment advisory fees. [2] Net of management fees. Performance results since January 1, 1999 were obtained using sub-advisers engaged by CB&T. Assets under management using this small cap strategy range in amount from $2.6 million at January 1, 1999 to $27.2 million at December 31, 2005. Small company stocks may be subject to a higher degree of market risk than the securities of more established companies because they tend to be more volatile and less liquid. [3] Net of management fees; performance results of SMC Capital and/or its principals as advisor from inception to 2/28/06 and as sub-advisors to CB&T since 3/1/06. [4] inception date 7/1/93. [5] inception date 1/1/1999. [6] Inception date 7/1/1989. [7] Index began 12/31/1993.

Fixed Income

Treasury yields continued their substantial decline during the third quarter after being range bound earlier this year. The widely quoted 10-Yr dropped 0.42% to 2.51% while the 2-Yr ended near the low at 0.42%. In August, the Federal Reserve reintroduced quantitative easing. It restarted buying longer-term Treasuries as part of a program to reinvest principal payments on its holdings. Near-zero money rates continue to create phenomenal demand. Total bond fund flows are running at roughly $30 billion per month according to ICI. As measured by the Treasury Inflation Protected Securities (TIPS) market, 10-year inflation expectations were little changed in the quarter at a modest 1.8%. Thus, real yields continued to fall and are hitting record lows. TIPS are also part of the Fed purchase program. There is growing debate over a bond bubble. We believe subdued inflation and subpar growth can support extremely low rates for some time. That said, multi-year return scenarios could easily become negative within the fixed-income space.

The Federal Open Market Committee (FOMC) language continues to suggest that the Fed Funds rate will remain near zero for an extended period. On September 21st, their statement focused on inflation being too low. It also referenced additional accommodation, if needed, to support the economic recovery and to somewhat promote inflation.

For the quarter, U.S. investment-grade fixed indices again produced solid returns in the 2–5% range. This includes Treasuries, Agencies & Mortgage-Backed Securities as well as Municipals & Corporates. High Yield resurged from the previous quarter with returns approaching 7%.

Managed Equity Composite

Total return for the Managed Equity Composite was 10.83% for the third quarter of 2010 compared to 11.30% for the S&P 500, 16.57% for the MSCI EAFE Index and 11.29% for the Russell 2000 Index.

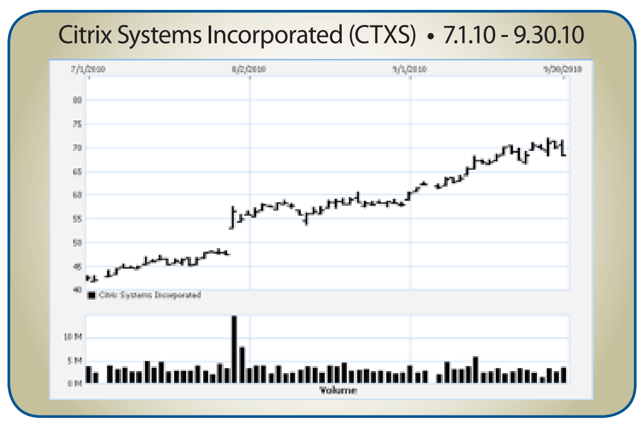
Shares of retail drugstore Walgreen (WAG) recovered most of its second quarter decline, posting a 26% gain for the third quarter. The stock was propelled 11% higher in late September after their earnings announcement soundly beat estimates. The stock had fallen as far as an 11x price/earnings ratio which was equal to the low bear market multiple we saw in 2009. We were especially pleased with the 27% increase in the dividend this quarter. Although energy remains a slight laggard this year, some energy names produced excellent returns: Chevron (+21%) & ConocoPhillips (+18%).

Healthcare (+4%) and Financials (+9%) continued to be challenging sectors this quarter. Healthcare device makers such as Medtronic (MDT, -7%), Stryker (SYK, 0%) and Zimmer (ZMH, -3%) have struggled over the past year as price pressure has risen. Within financials, institutions such as Bank of America (BAC, -9%) & JP Morgan (JPM, 4%), have underperformed due to the concern and uncertainty stemming from the financial reform bill (FinReg) signed into law in July. We believe that both of these sectors face short-term headwinds, but long-term valuations are continuing to look more attractive as we turn the corner on recession.

Science & Technology Strategy

The information technology sector posted a sharp rally in the third quarter as fears of a double dip recession receded. The Science and Technology strategy finished the quarter up 14.64%, versus the tech-heavy Nasdaq 100, (up 15.08%). As has been the case for 2010, the corporate market within the larger technology industry continued to outpace the consumer market, as multinational companies sought to upgrade their data infrastructure. A key beneficiary of this trend was Citrix Systems (CTXS), which saw its shares climb 61.59% for the September quarter, driven by robust enterprise demand for its remote data access products. In addition, Informatica (INFA, 60.85%) experienced continued sales momentum in its data mining software for large corporations. Going forward, the company remains a likely takeover target among enterprise software firms.

Hewlett-Packard (HP) similarly reported better-than-expected top line results driven by infrastructure investment. The stock, however, represented the strategy's laggard for the quarter. HP shares declined 2.80% in the wake of the sudden resignation of CEO Mark Hurd, who stepped down amid allegations of an inappropriate relationship. Hurd had been viewed as the chief architect behind HP's profit recovery and, as such, investors grew worried that the company's continued financial performance would wane under new leadership. Going forward, we feel this concern is overblown. As a peer to tech giants IBM and Cisco Systems, HP remains one of a select group of global-scale suppliers to multinational corporations. Moreover, the company's increasing emphasis on sales of high-margined software coupled with productivity gains in computer services should allow HP to post earnings growth above the industry average. As a result, we feel the stock represents an attractive risk/reward at its current valuation and we continue to maintain a core position in the stock.



Tax Managed Strategy

The Tax Managed Strategy rallied with the overall market in the third quarter, beating the S&P 500 by a nose with an 11.32% return for the period vs. the S&P return of 11.30%. Although the portfolio still trails the S&P year to date, it remains solidly ahead of the index since inception. Top performer, Qualcomm (QCOM), saw its shares rally 37.43%, driven by increasing evidence that Apple has tapped the company to be a key component supplier for the next-generation iPhone. As we look out to 2011, Qualcomm's earnings growth should outpace that of the overall information technology industry as smartphones such as the iPhone and Google's Android continue to take market share from voice-only cell phones.

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Small Cap Composite

The Small Cap Value Composite returned 9.07% for the second quarter of 2010, versus 9.72% for the Russell 2000 Value index.

Within the Composite, the sectors with the highest contribution to relative performance during the quarter were Financials and Industrials. While stock performance among our Financials was in-line with the index, the Composite benefited from a significant underweight position. The Composite's Industrials holdings benefited from positive stock selection. The Composite's top contributor during the quarter was specialty dispensing systems manufacturer, AptarGroup Inc. (ATR). Aptar, also the Composite's largest holding, delivered organic growth of +22% with contributions coming from all business segments. Furthermore, Aptar increased its annual dividend 20% to $0.72/share and repurchased $25 MM of its shares during the period. In addition to strong results, shares of Aptar have benefited from heightened M&A activity in the packaging industry.

The sectors with the lowest contribution to relative return for Q3 were Consumer Discretionary and Consumer Staples. In both sectors, the Composite's underperformance was due primarily to stock selection, as our low beta holdings did not keep up with the high beta outperformance in these groups.

Aptar Group Inc. (ATR) • 7.1.10 - 9.30.10

The largest negative contributor to performance in Q3 was for-profit education company Lincoln Educational Services Corp. (LINC). In early Q2, we built a position in Lincoln with the belief that Congress and the Department of Education (DoE) would encourage vocational training at this and other institutions in a high unemployment environment. In late July, however, draft legislation issued by the DoE sought to limit the availability of government funding in the for-profit education industry under a proposal called 'Gainful Employment.' Despite these regulatory headwinds, we mistakenly believed Lincoln's higher-quality status in the industry would support our investment. On August 16, the DoE released unfavorable repayment rate statistics for LINC and most of the sector. In response, we eliminated this holding from the Portfolio.

While we cannot say that stocks are currently over-priced, our valuation measures indicate that investors should be cautious. Fortunately, we believe our Composite is well positioned for the current environment. We remain steadfastly focused on stocks with stable growth, attractive valuations, and healthy balance sheets and continue to focus on identifying companies that we believe will make attractive acquisition targets.

Multi Cap Composite

For the third quarter of 2010, the Multi Cap Composite gained 4.4% versus the S&P 500 Index, which had a gain of 11.3% for the quarter. For the full nine months of 2010, Multi Cap Composite has gained 3.3% in comparison to the S&P 500 Index return of 3.8%.

Our defensive stance, which served us well during the difficult first two quarters of 2010 proved less effective the past few months as Wall Street sentiment changed rather abruptly.

Though managing decent gains, the quarter was marked by no fewer than five significant declines and six recovery surges. Some of our winners this quarter include Apple Computer (AAPL) – again – with a 13% gain during the quarter. Mastercard (MC) "charged" ahead 12.5% during the quarter and two of our ETF holdings, the S&P 400 Midcap Index (MDY), and the ishares Russell 2000 index, gained 12.4% and 12.1% respectively. It appears that the improved interest in stocks had a disproportionately strong influence on smaller companies, helping the ETF's to outperform the S&P 500.

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Caterpillar (CAT), runner up for top performer, also posted an impressive gain for the quarter, climbing 30.98%. Investor sentiment turned positive on the industrial sector, as concerns of double dip recession diminished. In addition, thanks to secular demand for heavy equipment in developing countries and the mining industry, Caterpillar has continued to post revenue growth well ahead of Wall Street consensus, propelling the stock. Investors' shift to the more cyclical sectors of the stock market, however, negatively impacted the stock price performance of the defensive sectors of the S&P. One example is military contractor Lockheed Martin (LMT), which represented the strategy's laggard for the third quarter. Lockheed shares declined 4.32% in Q3, offsetting the strength in the industrials. Nevertheless, we will continue to maintain our holding in Lockheed going forward, in accordance with our long-term investment discipline. And as an established leader within in its sector, we feel that Lockheed will continue to outperform its peers in the long run.

Kentucky Municipals

For the quarter, tax-exempt returns were 3 - 4% throughout most of the curve. Short-term maturities were the obvious exception. Supply/Demand dynamics continue to be the key. By the end of the quarter, KY bond inventories had become fairly robust, particularly with bank qualified (BQ) paper. This was largely due to refunding deals given the drop in rates. This translated into welcome price reductions on a number of recent deals. It has also created a buying opportunity on new issues as well. Some refunding deals were cancelled or rejected. We have discussed that current rules mean that most KY deals are BQ. Typically, BQ bonds yield less and a return to normalcy would translate into relative performance. Finally, historical valuations as compared to Treasuries remain attractive. We will be watching the tax legislation closely as the Bush era cuts are due to sunset. Tax exempts should benefit to some extent, depending on the outcome.

Quarterly bond issuance by Kentucky municipalities was again substantial at $1.28 billion with 110 issues. New issue size averaged $11.7 million. Taxable issuance accounted for $631 million or 49% of the above total. As advocates of taxable municipals, we welcome the supply. BQ issuance only accounted for $397 million or 31% of the above total.

During the quarter, our 10-year KY tax-exempt yield target fell 0.35% to 3.10% from 3.45%. This compares to 3.35% a year ago after an extremely strong quarter. 4% seems to be a strong central tendency for the 10-year rate over various interest rate cycles. Our 15-year yield target fell 0.45% to 3.60%. This compares to 3.95% a year ago.

outlook

Comments on the third quarter and current market environment:

- Despite mixed economic news, the U.S. stock market witnessed a strong rally; returns in foreign markets were even stronger
- It was a quarter of reversals, with stocks reaching a bottom in early July after a 16% correction and finishing with the best September since 1939
- Investors returned to the China-driven demand theme, with emerging market and commodity oriented investments staging a strong recovery
- Bonds had low single digit returns for the quarter, but remain strongly positive for the year-to-date and ahead of stocks

As we look forward, here are a few recommendations and themes we expect to continue:

- This economic cycle was driven by a debt boom and bust and therefore may not be comparable to cycles of the past few decades
- Years of de-leveraging (paying back debt) and increased regulation (taxes?) will mean slower growth than what we see in normal recoveries
- There is still a lot of risk in the system and most asset classes are not what we consider cheap
- That being said, there are many ways that we can add value in this type of environment
- We continue to recommend the following strategies as a way to navigate the turbulent times:
  - High-quality ("All-Weather") stocks with strong economic moats bought at attractive valuations
  - Investment income strategies – with interest rates so low, we like investments that can produce and grow solid yields
  - Our expectation for future fixed income returns are low, leading us to select some alternative and flexible fixed income strategies
  - Alternative asset funds that have the potential to improve adjusted returns

Our comprehensive wealth management service integrates Commonwealth Trust Company's wide-ranging capabilities and highly qualified staff, with a network of external resources and advisors you may designate, such as your personal attorney or accountant. Coordinating these resources, our team of professionals can provide you with the following services:

INVESTMENT MANAGEMENT:
Our staff of investment professionals can serve as a full-service investment advisor, establishing investment objectives, developing asset allocation, analyzing risk, constructing portfolios and monitoring and reporting on performance.

TRUST & ESTATE PLANNING:
Our staff of experts can help develop plans for the effective transfer of assets through wills and trusts. We have extensive expertise serving as trustee or co-trustee for all types of personal and corporate retirement plan trusts, including trusts that have direct investments in private companies, real estate or other less liquid assets. We may also assist with the settlement of estates, serving as executor or personal representative.

CHARITABLE PLANNING:
Our team is highly experienced in all aspects of charitable planning. We can help you locate worthy charities in your area of interest or help you leverage the value of charitable gifts to your pre-selected organization(s). Our expertise will allow you to maximize your charitable giving for the benefit of you and the recipient.

TAX, IRA, AND RETIREMENT PLANNING:
Our staff of experienced financial planning professionals can help minimize the burden of estate, inheritance and income tax through careful planning techniques. We can also assist with the creation or rollover of IRA assets.

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BROKERAGE & INSURANCE SERVICES:
Our staff of fully-licensed brokerage professionals can help you buy and sell a large selection of securities at competitive commission rates. We offer a variety of accounts designed to fit your individual investing needs and feature unique services to help you plan and implement your financial strategy. While still offering the strength and resources of a large financial organization, our personalized service will also provide you with a one-on-one approach and convenient local delivery.

Investment Research & Portfolio Management: Darrell R. Wells, Steve J. Giacobbe, CFA, CFP®, Holland N. McTyeire, IV, CFA, Stanley A. Rourke, Brian S. Stivers, James E. Moore, CFA, Stephen L. McCool, W. Shawn Clark, Christopher J. Beneke ***Trust & Estate Administration:*** Jack M. Combs, Jr., Mary Beth Byron, Patricia L. Hayes, Mark J. Kennedy, Christopher A. Nunnelley, Nancye W. Olt, Beth A. Russell ***Private Banking and Brokerage Services:*** Susan Roberts, Wendy O'Banion, Jill Cooper, Toby K. Nutt, Gregory T. Jacobs, Alan J. Griffes , CFP®, CTFA