

W. H. REAVES & COMPANY

INVESTMENT MANAGEMENT

SPECIALIZING IN EQUITY INVESTMENTS SINCE 1961

First Quarter 2008

Review and Outlook

The Quarter, 5 month and 5 year periods ended March 31, 2008 were exceptional periods. World equity prices peaked in October 2007. Since then "...in yen terms, the Nikkei 225 is down 24.1%, the S&P 500 is down 24.8% and the FTSE – Eurofirst 300 is down 24.5%. In [U.S.] dollar terms, these indices, covering totally distinct groups, are all down between 12.2% and 13.1%. And in Euro terms, they are down between 19.5% and 20.4%.”¹ From the October 12th market top through March 31, 2008 our clients’ portfolios were down as well, but not nearly as much.

It may not have been quite the perfect storm that roiled the equities markets in the first quarter of 2008, but it came close. Each portfolio sector declined, and three of the four, telephones, electrics and energy, were down significantly. From a relative viewpoint, however, the defensive nature and high-quality composition of our client portfolios stood out. Our clients’ portfolios outperformed the broad market by about 200 basis points in the quarter.² Client portfolios outperformed the broad market indices by significant margins.

Several factors account for much of the carnage. First, the deepening crisis in the credit markets spilled over to equities as investors judged the impacts of the housing crisis and subsequent credit squeeze on the overall economy to be more severe than they had previously thought. In our opinion, ongoing de-leveraging by some hedge funds and other highly levered investors also put significant pressure on equity prices. During periods of intense market turmoil, as we have recently experienced, investors “sell what they can” to raise cash. Often that means selling high-quality, dividend-paying stocks, including many of

our clients’ telephone and electric utility holdings. Indeed these two sectors, the highest yielding in our clients’ portfolios, were the hardest hit.

The extraordinary actions by the Federal Reserve in the first quarter eased pressures on the financial system by reducing short-term funding risk and improving liquidity for investment-grade securities. The Fed Funds rate was cut by 75 bps, the Discount Rate was cut by a cumulative 100 bps and, perhaps most importantly, the Fed allowed investment banks to borrow at its discount window. The Federal Reserve’s actions are in effect an unofficial recognition that investment banks are “too big to fail”.

Specific issues, linked to several companies in the portfolios, also accounted for some selling pressure. For example, concerns about a price war in the wireless sector heightened after Verizon, AT&T and T-Mobile announced ‘all-you can eat’ (i.e. unlimited wireless calling plans within hours of each other). In our opinion the sell-off was overdone, and we think the price points were set high enough such that rational pricing will continue to prevail. As we mentioned, the electric and telephone sectors in our clients’ portfolios declined most. However, to date we have observed no meaningful deterioration in the earnings growth outlook or the financial condition of electric utilities and telecoms in our clients’ portfolios. Almost without exception the electric utilities in the portfolio are expected to raise their dividends from as little as 4% to in excess of 14%. AT&T recently raised its dividend 12%.

Natural gas prices were firm and investors began to appreciate the potential for material growth of

gas reserves from Appalachian shale. We remain positive on gas utilities and natural gas prices. The need for additional electric generation in the U.S., we believe, will be met primarily by gas-fired generation for some time to come.

The volatility in the oil and oil service stocks has been extraordinary. The primary concern is that the price of oil will collapse from its current plus \$100 level in response to a world wide economic slowdown. The oil company investments in our clients' portfolios are based on a sustained oil price of \$65 per barrel. The need to replace reserves of oil and gas will continue to drive the demand for oil services, and the oil companies have meaningful cash reserves available for exploration and production services. Stock buy backs and dividend growth remain fundamental to the investment outlook for the energy sector.

In summary the market volatility since the market's peak in October 2007 and in the 1st Quarter of 2008 has not caused us to change our investment views of the fundamentals supporting our clients' portfolios' investments. The need for significant investment in U.S. energy infrastructure will motivate regulators and legislators to provide the rate support needed for selected utilities to finance construction of generation, transmission, distribution and pipelines. In the period ahead we will continue to apply our research driven, bottom-up investment process to the market sectors we research in order to achieve the solid, risk adjusted returns you have experienced with our firm in the past.

¹ Financial Times, John Authers, March 28, 2008

² Reaves performance data is the W. H. Reaves & Co., Inc. ERISA Composite. The WHR ERISA Composite reflects the dollar-weighted return of all corporate ERISA pension accounts with assets of at least \$1 million under management for all periods presented. Returns are time-weighted and include the reinvestment of all dividends and other earnings, net of commissions. The ERISA Composite does not reflect all of the firm's assets under management.

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