

Review and Outlook

First Quarter 2009

The equity markets, including our areas of concentration – utilities and energy - continued to be volatile in the first quarter, with wide swings in month-to-month performance. Overall our performance was negative, but significantly better (approximately 275 bps) than the broad market, represented by the S&P 500*.

Telephone stocks were among the best performers, although they too lost value over the period. For the industry as a whole, the issues remain broadly the same as last quarter. Wireless and wireless data, in particular, continue to be a source of growth that is more than offsetting the erosion of landline telephone service as more customers cut the cord and move to wireless-only service. The two major national players, Verizon and AT&T, are moving ahead with their plans to develop the next generation of wireless data services. Both companies view wireless data and the proliferation of machine to machine communications over cellular networks as the major growth driver. The economic slowdown is hurting enterprise-sourced revenue and may be accelerating the migration to wireless.

The electric portfolio was down. Regulated electric utilities, on the whole, fared better than utilities with significant unregulated generation assets and better than gas processors and transporters. The generators, of course, sell their output into unregulated power markets, where industrial and commercial demand is declining as the global economic slowdown deepens.

The valuation of gas companies in our portfolios continues to be hurt by falling natural gas prices, driven by new sources of supply coming on stream as industrial demand declines. During the quarter, the gas price fell from a high of \$6.11 per million BTUs on January 6, 2009 to \$3.59 on March 31st. For the short term, the gas markets continue to be over-supplied. As we've said before, this is not a situation that we think will endure.

Utilities and energy, in our view, present investors with real value in light of the market sell-off. The prices of nearly all the stocks in our portfolio have declined significantly since June 30, 2008 as global de-leveraging and a re-setting of the risk premium have taken their toll, indiscriminately, across the equity landscape. We don't think the fundamentals of companies that we own have deteriorated nearly as much. Utilities and telecoms provide largely non-discretionary services. Demand for these services may decline, and earnings may be less than we expected six months ago, but the fundamental ability of these companies to generate profit and pay dividends is not significantly diminished.

Several themes influence our portfolio decision making. Because we think market volatility will persist for some time, we start with a core defensive position composed of regulated utilities and integrated telecoms. On a three-to-five year time horizon, we think selected energy companies present a compelling value and will provide a hedge against future inflation, which is not a current threat, but is likely to become one given the size and scope of fiscal stimulus

currently being administered around the world. In the US, significant federal investment will be targeted to the national electric grid to replace aging infrastructure, to connect to new sources of wind and solar generation, and to pursue conservation goals. This will present investment opportunities in transmission, smart grid technology, and renewable generation.

While gas, which is the cleanest of the fossil fuels, is unattractive on a short-term basis, we remain bullish on the long-term outlook. The low price should depress new supply and stimulate demand. Over time, market forces will bring supply demand curves back in line. As part of the energy complex, it is a hedge against potential future inflation. In the current environment, gas prices remain quite depressed even as oil begins to climb. This creates opportunities for expanded margins for some gas processors producing natural gas liquids, the pricing for which tends to move in tandem with the oil price.

Dividend cuts have been much in the news recently. However, many of the companies that cut their dividends are financials with fundamentally flawed business models or industrials subject to rapidly deteriorating global demand. Dividend cuts by utilities remain a rarity; none of the utilities or energy companies in our portfolio has cut the dividend. Indeed we expect many of our companies to raise their dividends in the coming twelve months.

Access to credit markets has not been a problem for our companies, nor do we expect it to be. Nearly all of our companies have very strong balance sheets which help them sustain their dividend and give them access to credit.

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*The S&P 500 Index is a capitalization-weighted, composite index of 500 stocks designed to measure performance of the broad domestic (broad market) economy through changes in the aggregate market value of 500 stocks representing all major industries. The typical W. H. Reaves ("Reaves") portfolio includes a significant percentage of assets that are also found in the S&P 500. However, Reaves portfolios are far less diversified, resulting in higher sector concentrations than found in the broad-based S&P 500 index.