

Review and Outlook

Fourth Quarter 2008

Reaves' portfolio was down significantly in the fourth quarter of 2008 but was slightly ahead of the broad market. Performance over the long-term shows that from December 1998 through December 2008 the S&P 500* experienced a negative annualized total return of 1.4%, and a negative cumulative total return of 13.0%. This compares to a positive annualized total return of 4.8% net of fees (5.3% gross of fees), and a positive cumulative total return of 59.7% net of fees (68.1% gross of fees), for W. H. Reaves & Company's GIPS compliant ERISA Composite**.

Question: What has not changed since Countrywide Financial was sold to Bank of America and Lehman Brothers went bust? (See the answer at the end of this newsletter)

In 2008, trust between institutions and investors disappeared. Simple assets, traded in public markets, were sold indiscriminately. Stocks of companies which displayed the following characteristics; strong balance sheets, reliable earnings, dividends and liquidity, were sold because they could be sold...because *there were buyers*.

For now, many investors seem frozen. The principal challenge investors face today is investing to earn a risk-adjusted return which is adequate to meet the needs of current income, capital preservation and capital growth. What is an appropriate investment philosophy, process and portfolio to achieve these objectives?

W. H. Reaves & Co. (Reaves Asset Management) has been investing in the utility and energy sectors for 31 years. Our people, process and philosophy have produced excess returns above the broad market represented by

the S&P 500 during this time period. Our view is that a portfolio of well researched and select companies in these sectors will continue to produce better returns.

“.....the U.S. and many of its G-7 counterparts over the past 25 years have become more and more dependent on asset appreciation.we became a nation that specialized in the making of paper instead of things...”¹

By way of contrast, the businesses/investments in Reaves' portfolio provide products and services which are essential and necessary for everyday life; they are largely non-discretionary. The business model of telephone companies, electric, gas and water utilities and energy companies is not “broken”. Unlike financials, housing and autos, stockholders' equity has not been destroyed. Currently, we find that our portfolio companies exhibit the following:

- Sound balance sheets
- Strong ability to maintain and in some cases increase the dividend
- President Obama's fiscal policy embodied in the American Recovery and Reinvestment Act is likely to be beneficial for electric utilities, water systems and telecommunications.

Additionally, classifying utilities as a bond substitute is a simplification which overlooks salient investment characteristics of utilities and energy equities paying dividends:

¹ Bill Gross, Investment Outlook, January 2009

1. Dividend income increases over time for well chosen utilities and energy companies – bond coupons are fixed.
2. Book value grows as retained earnings are reinvested – a bond's principal is fixed.
3. Utilities and energy companies provide a hedge against inflation as a result of their rising income, dividends and net asset value.

At present, the fear of deflation is driving governments' efforts to re-inflate their economies. When the efforts to re-inflate take hold, it is likely the U.S. CPI will start to increase; portfolio inflation hedges should be considered.

In conclusion, we believe that select telecommunications, utility, water and energy companies will remain profitable in 2009 and continue to pay to their dividends and in some cases increase the dividend. Price earnings ratios are modest with respect to expected earnings, and dividend yields are rising and high relative to Treasury bond yields. Given the current economic downturn, accompanied by low interest rates and low U.S. CPI (averaging 1%, as an example), investment in our type of portfolio merits consideration. Finally, dividends and dividend reinvestment are essential to the success of our investing. It appears that there is a renewed appreciation and acceptance by investors of dividends' contribution to profitable investing.

Answer: Baby-boomers are still going to retire (maybe a little later now) and are going to need current income. Where will they find this? Treasuries? Junk bonds? Maybe, but what about dividend income from healthy companies? We think we can help for those who think it will come from equities.

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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.

**The firm, as defined as W. H. Reaves & Company, has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®). GIPS® has not been involved with or reviewed W. H. Reaves' claim of compliance.

Reaves performance data is the W. H. Reaves & Co., Inc. ERISA Composite and unless otherwise noted, all data is net of fees. 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. Net performance reflects the deduction of advisory fees which are described in detail in Part II of our Form ADV. Gross performance does not reflect the deduction of investment management fees and transaction costs which would reduce the performance shown. The ERISA Composite does not reflect all of the firm's assets under management.