

Review and Outlook

Fourth Quarter 2009

“TIRED OF THE PUNY YIELDS ON YOUR BONDS? Worried that interest rates and inflation will rise, clobbering their prices? Now may be the time to start moving into high-yielding stocks, while scaling back fixed-income holdings. This means buying utility and telecom stocks, which have lagged behind the overall stock market this year, as well as master limited partnerships focused on the transportation of natural gas and oil-related products”. (Barron’s, Even Better Than Bonds, December 7, 2009)

As a new year and a new decade dawns, we believe that investors will be well-served by the above-cited advice from Barron’s. Given the fragility of the economic recovery and the threat of future inflation, we cannot think of a more appropriate time to have a portion of your investment in a portfolio of relatively conservative equities that can generate meaningful yield from a rising stream of dividends and offer exposure to basic commodities in the form of oil and gas assets. Simultaneously you have investment exposure to companies providing critical components of the communications and energy infrastructure.

As we begin 2010 we believe there is the potential for positive total returns for the very reasons mentioned in the Barron’s quote: utility and telecom stocks carry reasonable valuations, have strong cash flow, sound balance sheets, and relatively stable business operating environments. Lastly, the companies’ dividend yields are, in many cases, competitive with corporate bond yields and superior to government bond yields.

In the fourth quarter the gas sector delivered the best relative performance among our sectors, driven largely by companies that process and transport natural gas, which remains the carbon fuel of choice. Recent improvements in technology to allow the profitable extraction of gas from shale and recent discoveries of gas in the Marcellus shale, close to Northeast markets, have

stimulated investor interest even in the face of the current oversupply of gas. We remain focused on companies that gather, process, and transport natural gas. The ongoing disparity between oil and gas prices has benefitted natural gas processors who produce and sell natural gas liquids which are priced relative to the price of oil.

The electric utilities sector followed gas in terms of generating positive returns, with the regulated utilities driving the strongest performance. We think the sector benefitted partly for technical and partly for fundamental reasons. We believe there was a general movement toward more defensive positions at the end of the year as investors sought to lock in gains. On the fundamental side, several of our companies reported favorable rate cases while another required a smaller equity offering than the market anticipated. Perhaps most fundamental of all, the nation stepped back from passing carbon legislation in 2009. Until we have more clarity on the economy and carbon legislation we will continue to favor regulated utilities in selected states with favorable regulatory regime and companies investing in transmission.

The telecom and energy sectors also produced positive returns. Integrated telecoms, in our view, benefitted partly from the same technical trends that helped boost electric performance – investor demand for relatively defensive names at year end. Fundamentally, though, both major US telecoms generate substantial free cash flow; have been able to develop new revenue sources from wireless and broadband as legacy wireline voice revenues atrophy; and are reducing costs in the face of declining commercial demand for network services. While their businesses have come under considerable economic and competitive pressure, they have remained profitable and are able to sustain record levels of capital investment in video, broadband, and wireless technologies from internally generated funds as they continue to increase their dividends.

The positive return achieved by the energy sector was driven by the strong performance of several of the integrated majors and of oil service companies. Our fundamental view on energy remains bullish, although we concede there may be considerable volatility as the market scours upcoming economic reports for signs of growing or slackening demand and as it evaluates geopolitical developments in the major oil-producing regions of the world. To cushion the effects of the expected volatility, the energy portfolio includes several high-yielding integrated majors and oil service companies. We expect the demand for oil service technologies to grow as the integrated majors and the national oil companies seek to maintain and grow current production.

Overall we are cautiously optimistic about 2010. We expect our regulated utility and telecom investments to provide stable income and a modicum of growth. Oil and gas production, processing and transport offer opportunities for more substantial capital appreciation and a hedge against future inflation.

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