Reaves Asset Management

Review and Outlook

First Quarter 2010

The first quarter of 2010 was largely a period of market consolidation in our sectors. Overall results were flat with telecom and utility performance down modestly, offset by positive performance in the energy sector.

The telephones gave back much but not all of the gains they had achieved in the prior quarter. Several dominant trends persisted. Concerns about growing price competition were heightened early in the year when the two major wireless carriers in the United States announced lower price plans within a day of each other. The earnings outlook for 2010 was generally muted as carriers continue to deal with the headwinds of slowing commercial demand largely stemming from very high unemployment, rising pension costs, and a wireless market fast approaching saturation in the US. The quarter also saw a number of positive developments. A recently completed merger between two largely rural wireline carriers appears to be on track and delivering on the synergies promised. A second key merger in the rural telecom space appears likely to close by the end of the second quarter of this year. We expect this to be accretive to cash flow and to result in improved financial metrics for the new company. The recent introduction of the iPad holds out the promise of many new data applications spurring demand on wireless networks. Indeed the National Broadband Plan, released by the US Federal Communications Commission in March, emphasized the need to clear additional spectrum to meet the expected demand for wireless broadband services.

The energy sector produced modestly positive results with the best results coming from companies that process, store and transport natural gas. During the period, the price of natural gas (Henry Hub US Spot) declined from $5.83 per million BTUs to $3.92 per million BTUs. Declining prices are largely the result of lower industrial demand and growing supply. Gas production from shale deposits across North America is expected to grow dramatically in the next few years. In our view these new sources of gas supply will be able to meet anticipated growth in demand as economic recovery continues and as gas displaces coal in electricity production. Our investment thesis does not require major improvements in gas prices; it is based, rather, on the expectation of significantly increasing gas volumes. We therefore tend to favor investment in low-cost gas producers that can thrive in a relatively low-price environment and in companies that have the capacity to process, store, and move large quantities of natural gas.

Selected oil service companies also performed well as investors look ahead to growing demand for oil attendant to economic recovery. Results were mixed for the integrated majors

Shares of utilities were down slightly in the quarter. Regulated utilities generally performed better than generators. Demand for electricity remains suppressed, mostly a result of the economic downturn, but partly a result of heightened conservation efforts. We expect conservation to have a dampening effect on electric demand going forward. In this environment we continue to favor regulated utilities in a position to grow rate base. The stalling of proposed cap and trade regulation in the Congress, in concert with reduced economic activity and the growing supply of natural gas will more than likely, in our view, push out the timetable for building new nuclear generation and stimulate the building of gas-fired generation. On the regulatory front, the situation in Florida has become more negative after the utility commission, acting largely out of political concerns, rejected rate cases proposed by the state's two major utilities. We think the political posturing will subside following the gubernatorial election in November and expect a re-vamped commission will adopt regulatory policy that supports capital investment in new infrastructure. Infrastructure investment creates jobs and increases property tax income as the assets go into service. The share price of both utilities came under pressure in response to the unsupportive regulatory decisions. We took advantage of this opportunity to increase holdings in two well-run companies with extensive regulated assets.

We remain cautiously optimistic about 2010. We still 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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