W.H. **Reaves** Asset Management

Review and Outlook

Third Quarter 2010

Our portfolios posted strong performance in the third quarter and outperformed the overall market as measured by the S&P 500.[1] Each major of our sectors, telecom, utilities, and energy posted double digit total returns. For a number of weeks during the quarter telecommunications and utilities were among the best performing industry sectors ranked by weekly percentage change. The superior dividend yields of the telcos and electric utilities apparently attracted income-seeking investors. The telcos and electric utilities experienced positive total returns in each month of the quarter, once again demonstrating their defensive characteristics in an uncertain economy. In contrast, the returns from the energy service and oil and gas sectors were quite volatile from month to month but nevertheless made a significant contribution to the quarter's total return.

At the very beginning of the quarter Verizon completed the divestiture of approximately 4 million (mostly rural) access lines to Frontier Communications as part of its ongoing strategic plan to focus on the faster growing segments of its business in wireless and fiber-based communications. In our view Frontier, a rural wireline carrier exclusively, is in a better position to manage those access lines profitably.

The regulatory environment for telecoms has improved since our last review. It now appears unlikely that the Federal Communications Commission will take the initiative to re-regulate broadband services under the more restrictive Title II of the Telecom Act. We think the internet policy proposals put forth by Verizon and Google, while eschewed by the FCC for the time being, are a major step in the right direction. They allow carriers and content providers to develop commercial arrangements to deliver advanced internet services with the potential for improved profitability. Pricing for wireless services remains relatively stable, albeit in a very competitive market. We are encouraged by the recent trend in the wireless industry toward tiered pricing for data services. Wireless data growth has been explosive evidenced by the surging popularity of smartphones.

Among utilities, our investment focus remains primarily on the regulated utilities in states with favorable regulatory regimes. The macro economic factors that contributed to the utilities' returns were: abatement of fears of a double dip recession, renewed investor expectations for continued low interest rates and a reduction in sovereign risk fears. With respect to selected utilities, favorable rate cases, new transmission projects, improved relations with state utility commissions, and an easing of concerns about carbon legislation improved investor sentiment. We expect demand for electricity to continue to be relatively weak in the quarter, dampened by the slow economic recovery and successful conservation efforts.

[1] 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 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.

S&P Data is shown strictly for comparative purposes and should not be considered a benchmark for the Reaves investment strategy. Reaves data used represents actual composite performance over the investment period.

Decoupling of electric utility revenues from sales has been adopted in some states and is under consideration in some others in an effort to reduce growth in electricity consumption. As a result, we continue to avoid the generators. In states that have adopted decoupling, the regulated utility is allowed to earn a return on its investment in conservation programs.

The outlook for increased natural gas utilization remains favorable. Gas utilization in the US will grow because it is the cleanest of the fossil fuels and domestic supplies are ample. A political consideration is that natural gas can be a substitute for imported oil from the Middle East and elsewhere. Significant gas price increases are not expected because growing demand can be met by growing supply from various domestic sources, including shale. Companies in a position to profit from increased gas volumes are focused on gathering, processing, transport, and local distribution.

Price volatility in the energy sector has been driven largely by events in the Gulf of Mexico. We expect exploration in the Gulf to recover slowly following the lifting of the moratorium because there will be a more cautious approach to granting licenses and increased regulatory oversight, which in turn will drive up operating costs. Drilling assets may well be moved to other locations around the world, with Brazil a likely candidate. As an example, Petrobras recently raised $67 billion to develop deep-water deposits off the coast of Brazil. We have a favorable view of oil service, particularly international oil service, and several integrated majors. We consider valuations and dividends at current levels attractive.

The outlook for regulated utilities and telecom stocks remains favorable in the fourth quarter. The interest-rate outlook promises to be benign for quite some time as the Federal Reserve prepares for another round of quantitative easing. Selected utilities and telecom companies simultaneously offer equity yields well in excess of 4% and the opportunity for meaningful earnings growth.

For further information contact:
Gerald C. Pinkerton
Chief Marketing Officer
W. H. Reaves & Company
10 Exchange Place, Jersey City, New Jersey 07302
Telephone (800) 975.8395
Facsimile (201) 332-8593
gpinkerton@whreaves.com
www.whreaves.com

For further information contact:
Rowland O. Wilhelm, Jr.
Vice President, Director of Sales and Marketing
W. H. Reaves & Company
10 Exchange Place, Jersey City, New Jersey 07302
Telephone (201) 793-2383
Facsimile (201) 332-8593
rwilhelm@whreaves.com
www.whreaves.com