



Mid-Quarter Newsletter

May 15, 2010

From My Corner

Jeff Mengis – President

Market Comments: Following the first market correction since the strong rally from the March 2009 lows, we wanted to review where our portfolios are focused. As is typical with the first year of a recovery, cyclicals and financial stocks led, P/E multiples expanded as earnings rebounded and investor confidence increased. At this point in the market cycle, we are overweight companies in the energy, health care and technology sectors that offer growth at a reasonable price. While there are certain financial companies we find attractive, our portfolios are underweight the sector because we believe that increased regulation and non performing assets will weigh on the industry for some time.

Our strategy when allocating capital has been to focus on the relative value of individual companies. Over the long-term, companies in the energy sector should benefit from rising energy prices as supply constraints converge with a more global economy. Even during the recent downturn, amid the worst recession in decades, capacity utilization of oil was at 95%. Once the economy has recovered, the price of energy is likely to increase. Recently, performance of this sector has been disappointing as a stronger dollar has driven the price of oil lower. In addition, the gulf oil spill has weighed on companies with drilling exposure. However, those fears have created opportunities in solid companies like Exxon Mobil (XOM), which has about \$1.6 trillion in proven oil equivalent reserves.

We are also overweight in health care companies that should benefit from an aging demographic trend and provide some defense if the market were to double dip. A company like Abbott Laboratories (ABT) is trading near a 52-week low, primarily due to concerns about a weaker European Union impacting their sales. The pullback means an investor with a long-term view can buy Abbott at a historically low cash flow multiple and earn a 3.6% dividend yield while waiting for the stock price to improve.

Lastly, the fundamentals behind the technology sector reflect strength not seen since the late 1990's. An upgrade cycle driven by new software and strong demand from emerging economies should enhance profits in the industry. We favor a company like Intel, which is forecast to see record earnings in 2010 and pays a 3% dividend.

Investment Focus:



Marathon Oil (MRO) is the 4th largest integrated energy company based in the United States. About 70% of Marathon's revenues are derived from oil exploration and production, while about 30% is from refining and marketing division. Marathon is weighted more toward refining than most integrated oil companies. While it is a challenging environment for refineries, Marathon has a competitive advantage in that their geographic footprint in the Midwestern U.S. is not as vulnerable to imported fuel as coastal refiners. Marathon's oil exploration business provides the potential for upside. Production from a major platform in the Gulf of Mexico, combined with an oil sands project in Alberta will help to boost Marathon's cash flow by an estimated 12% by 2011. In addition, they have rights to about 336,000 net acres in the increasingly important North Dakota Bakken shale, which is currently estimated to produce 22,000 barrels of oil equivalent per day within 3 years. While this is a small part of their overall production, it provides a geopolitically safe, low cost source of oil.

Marathon currently trades at a discount to its peers because their exploration and production projects tend to have a higher cost per barrel of oil equivalent to produce, making the stock more tied to the price of oil. In addition, news of the gulf oil spill has created some pause around all deep water drilling. Realistically, given our countries tenuous energy position, we see little alternative but to drill in the gulf. Marathon's stock trades at about 4.5X 2010 forecast cash flow, allowing the company to pay a 3.3% dividend.

Marathon Oil Corporation Common

