

Mengis

CAPITAL MANAGEMENT INC.



Mid-Quarter Newsletter

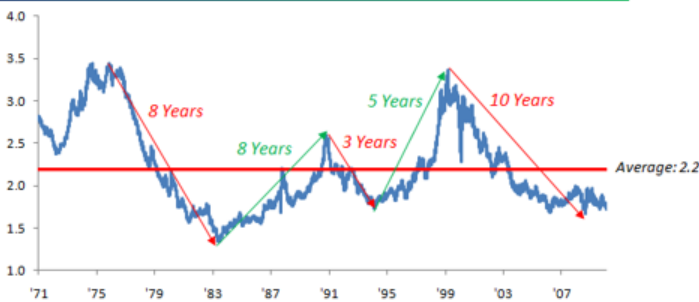
February 15, 2011

From My Corner

Jeff Mengis – President

When building individual portfolios, we look to invest in companies that offer growth at a reasonable price. In the current environment, we feel that large-cap companies offer relative value. Many of these blue chip companies have strong cash flows and historically low debt, which allows them to pay a solid dividend and helps reduce volatility. The world is becoming more global and developed countries are being joined by enormous emerging economies like China, India and Brazil. We believe multi-national large-cap companies will have an advantage over small-caps, which tend to be more dependent on the domestic economy.

Ratio of S&P 500 to Russell 2000: 1971 - 2010



The chart above (courtesy of Bespoke Investment Group and Seeking Alpha) shows the ratio of the S&P 500 versus the Russell 2000 over the last 30 years. A ratio below the red average line indicates a prolonged period of outperformance by small-caps. Over the 10 year period from 1999-2009, small-cap stocks outperformed large-caps, which would suggest that we are due for a period of outperformance from blue chip stocks.

As emerging markets develop, we favor companies similar to Intel (INTC) or Qualcomm (QCOM) that have the ability to make specialized chips for the world's computers, tablets and smart phones. In addition, 3M (MMM), which sells over 50,000 products in 60 countries including transportation, health care, consumer and communications will benefit from new customers worldwide. The growth of China, India and other emerging economies is definitely a long-term story, but as their 2 billion citizens play a larger role in the global economy, we are optimistic that large-cap companies will benefit.

Investment Focus:



Chevron (CVX) is the second-largest U.S.-based energy company after Exxon Mobil and the smallest of the world's five "super major" oil companies according to research provided by Argus. Oil prices have been increasing recently due to an improving economy and uncertainty in the Middle East. As an integrated energy company that derives 86% of its earnings from exploration and production, the company stands to benefit from the recent rise in oil prices. Chevron typically takes a multi-year approach with its exploration investments. They recently increased their expenditure budget by 19% in an effort to increase their proven reserves through new oil well discoveries. In addition, Chevron just completed the acquisition of Atlas Energy, a gas shale company with significant reserves in Pennsylvania's Marcellus field. With a debt to capital ratio of just 11%, the company is in a strong financial position, allowing management the flexibility to make additional acquisitions if appropriate. In terms of relative value, Chevron is attractively priced. The company trades at less than 10X consensus earnings estimates for 2011 and offers a 2.8% yield. With expectations for Chevron to grow profits at 8.5% per year over the next three years, we believe their total return prospects are favorable.



With one of the most recognized name brands in the world, **Walt Disney (DIS)** is a company that needs no introduction. While Disney is well known for their theme park and movie studio businesses, the media networks, led by ESPN and ABC produce more revenue than any other division. In 2010, 45% of revenue was generated from Disney's media networks, 28% from their parks, resorts and cruise line, 18% from their movie studios and 9% consumer products and interactive media. In the final quarter of 2010, Disney saw a strong increase in advertising demand, particularly at ESPN, which experienced a 34% increase in year over year revenue. Therefore, Disney appears well positioned to benefit from increasing advertisement revenue. If the economic recovery continues, the company's theme parks and cruise line should prosper from a resumption of leisure travel. Disney appears reasonably valued given that it trades at 16.5X 2011 earnings, with consensus estimates forecasting 16% annual profit growth through 2013. One potential risk that would negatively impact advertising revenue at ESPN is a prolonged lockout by the NFL and NBA. However, we believe that Disney's product diversification and highly regarded management team will tackle obstacles and continue to grow the company.