

MARKET OVERVIEW

United States

Don't be lulled by the indolent tranquility that has settled over Wall Street the past several weeks. The stock market is on a roll. Stocks are coming off their best first-quarter performance in a dozen years, up 5.2 percent year-to-date. And, it's the fourth consecutive up quarter, the market's best streak since the five-quarter run that ended after the third quarter of 2007. The quarter's gains might not seem like much considering the jumps during the past three quarters as stocks roared back from bear market lows. Remember, though, that halfway through this quarter the market was on the verge of its first correction – *a harried 9 percent fall* - since the bull market began. But since the February drop, the market



continued to trend higher. Industrial and financial stocks paced strong first quarter gains, and are now moving ahead of last year's winners. Since the beginning of the year, the industrial sector is the leading group, up 12.9 percent, followed by financial and consumer discretionary companies, rising 11.5 percent and 10.9 percent, respectively. This quarter, investors have seen a reversal of capital inflows from last year's levels amongst the major S&P 500 sectors. Technology and basic material stocks, for example, which emerged as the leaders in 2009, are now up the least. On average, S&P 500 stocks outperformed the overall gains for the NASDAQ 100 components and Dow 30 companies by one and two and a half percent, respectively. So far this year, companies in the S&P index posted an average gain

U.S. Growth Leaders Portfolio Top-Ten Holdings

- 1) **Apple**
- 2) **Exxon Mobil**
- 3) **Coca Cola**
- 4) **Oracle**
- 5) **Abbott Labs**
- 6) **Zimmer**
- 7) **Google**
- 8) **Gilead Sciences**
- 9) **Xilinx**
- 10) **Novartis**

U.S. Value Leaders Portfolio Top-Ten Holdings

- 1) **Ford Motors**
- 2) **Walmart**
- 3) **Hershey**
- 4) **3M**
- 5) **Southern Co.**
- 6) **Intel**
- 7) **Proctor & Gamble**
- 8) **Bristol Myers**
- 9) **Chevron**
- 10) **Total SA**

Global Growth Portfolio Top-Ten Holdings

- 1) **Eisai**
- 2) **AXA**
- 3) **Novartis**
- 4) **Schering Plough**
- 5) **Delhaize**
- 6) **SAP**
- 7) **Matsushita**
- 8) **Mizuho Financial**
- 9) **Citigroup**
- 10) **Teva Pharma**

of 8.1 percent with a median gain of 6.5 percent. Of the major economic sectors, the fact that technology has fallen behind is remarkable. Technology stocks make up the biggest chunk, or 19%, of the S&P 500 and have been one of the most consistent performers in regard to revenue and earnings growth. However, the gain of the overall sector was just 1.8% this quarter. That puts technology stocks in seventh place behind gains of industrials and financials. As the rally matures here in 2010, managers seem to be booking profits on 2009 winners and steering money from tech companies that benefit from corporate spending to the kind of cyclical, consumer stocks that bloom when the job market recovers. It is no wonder the automobile companies have fared so well. The top-performing industries of the quarter are a motley crew including resorts & casinos (+136%), toy & hobby stores (+42%), and life insurance (+30%). Other than resorts, major airlines (+22%) and hotel REITs (+22%) also cracked the top 10 industries, showing that investors may be betting that consumers are getting ready to travel again. On the flip side, reinsurance (-58%), trucking (-48%) and music & video stores (-47%) were the worst performers in the quarter.

In mergers and acquisitions, activity was strong as increasingly confident firms looked to expand or roll up industries. Kraft raised its offer for Cadbury to finally seal the deal for the British confectioner. Oil services firm Schlumberger, a holding in the growth portfolio, agreed to acquire rival Smith International for \$11 billion. And new purchase Coca-Cola followed in Pepsico's footsteps and decided to bring the North American operations of its largest bottler, Coca-Cola Enterprises, under its own roof. The IPO (initial public offerings) market remained open in the first quarter. The largest issues were for Sensata Technologies, which raised \$550.8 million, and Symetra Financial which raised \$364.8 million. For the official quarterly statistics, The Dow Jones Industrial Average (Dow) gained 4.1% or 428.58 points during the first quarter, to 10856.63. That marked the Dow's fourth consecutive quarterly gain and the best first-quarter performance since 1999. The broad Standard & Poor's 500-stock index rose 5.2% to 1169.43. Despite this good first quarter gain, the index still remains 25% below its all-time high posted in October 2007. As has been the case since stocks hit their lows in March 2009, the best-performing stocks have tended to be the most volatile and generally lower-quality names. The Russell 2000 index of small-company stocks posted the largest gain among the big benchmarks with an 8.5% rise. The Nasdaq Composite Index a 7.1% gain for March and 5.7% rise for the quarter. The markets benefited from the removal of the " economic collapse" possibility that was predicted back in March.

Quite remarkably, it wasn't the passage of a 2,409-page health-care bill that promises to raise taxes on dividends, capital gains and Medicare for wealthier Americans that shook the stock markets. Stock traders took the new gargantuan bill in stride, and focused instead on the prospect of improving corporate profits, as companies from Best Buy (BBY) to Qualcomm (QCOM) raised their forecasts while Starbucks (SBUX) announced its first ever dividend. But although stocks are shining, there is quite a bit of worry for the future of the bond markets. Faltering demand for a big slug of debt the government was auctioning in late March sent prices lower and drove the yield on 10-year Treasuries toward 3.9%, the highest level since last June. Economic recovery would be fine and well if inflation does not flare up and long-term interest rates stay benign. But the specter of rising borrowing costs from our own Government brought on a bout of vertigo and caused 10 year interest rates to nearly break 4%. The SIPCO investment team considers the 4% level very breakable.

Most individual retail investors have not been participating in the rally. According to Morningstar, investors pulled \$3.7 billion out of U.S. stock funds in February, the fifth month of outflows in the last six months. A Mar. 25 survey by the American Association of Individual Investors showed 34.7% of respondents are bearish, which is more than the 32.4% who are bullish and up from a 23% bearish reading at the end of 2009.

Europe

The FTSE 100 was up 4.9 per cent while the FTSE Eurofirst 300 advanced 3.2 per cent. The turmoil in Europe moderated returns on continental stocks, with France's CAC-40 gaining just 1% German stocks climbed, with the benchmark DAX Index posting the longest streak of quarterly gains since 2007, as a report showed unemployment in the country unexpectedly fell in March. The DAX rose 3.3 percent, as the European Union agreed on a contingency rescue package to help Greece cut Europe's biggest budget deficit. The broader HDAX Index gained 3.2 percent. The number of people out of work in Germany fell a seasonally adjusted 31,000 to 3.38 million. Economists had forecast an increase of 7,000, according to the median of 33 estimates in a Bloomberg News survey. The jobless rate declined to 8 percent from 8.1 percent. One of the largest gainers in the quarter in the German market was Fresenius Medical. Fresenius's common stock surged 16 percent as the world's biggest provider of kidney dialysis proposed to convert all its preferred stock into ordinary shares on a 1:1 ratio basis with no cash compensation and to change its legal status to KGaA. Deutsche Bank was one of the poor performers in the quarter, losing 1.7 percent to 57.03 euros. During the first quarter, German Finance Minister Wolfgang Schaeuble said he expects all German banks to pay between 1 billion euros and 1.2 billion euros annually into a bank crisis-prevention fund after parliament passes the law this year.

In Britain, quarterly stock market gains were led by the mining sector. Mining-sector investors expected that demand for metals will continue to rise against a stronger economic backdrop and boost profits for these firms. Reinforcing hopes for a strong global economic recovery, the market digested stronger manufacturing surveys from China, Europe, the U.S. and the U.K. The U.K.'s closely watched manufacturing PMI rose to 57.2 in March, up from 56.5 in February, to hit its highest level since October 1994, according to a survey by CIPS/Markit. The latest data underlines that the mining sector recovery is gathering speed and that the industry has the potential to be an engine of growth for U.K. The mining-sector gains helped the top British share index advance, with the index closing up 8.8% in the quarter.

Asia

The Nikkei climbed 5.2 percent in the January-March quarter, and rose about 37 percent in Japan's 2009/10 financial year. Buoyed by the global economy's recovery trend, the sea transport sector and commodities-related sectors such as metal products and nonferrous metals were the top gainers among sub-indexes in Japan so far this year, while defensive sectors such as food, as well as pharmaceuticals, have generally lagged behind. Though in the short term there are concerns about Asia overheating, analysts are getting more positive with expectations for Japanese earnings this year to rise substantially. Combine that with rising trading volumes and continued buying by foreigners,

the Japan market is looking up. A wave of foreign buying by investors who seriously underweight Japan last year has assisted the Nikkei play catch-up this year. Foreign investors bought a net 127.7 billion yen (\$1.38 billion) in Japanese shares in the week ending March 29, bringing their total net buying for the year to more than 1.9 trillion yen. That compares with net buying of just 28.7 billion yen for all of 2009. The Japanese currency's (yen) retreat from a 14-month peak against the dollar near 84.80 yen hit in late November lent support to the Nikkei this quarter.

In China, the Shanghai Composite Index lost 5.1 percent from January to March, the fifth-worst performer among 93 indexes globally tracked by Bloomberg, and the worst quarter since the three months ended Sept. 30, when the gauge fell more than 20 percent in August. Stocks fell in the past three months after the central bank twice ordered banks to set aside more money as reserves to rein in record new lending. China's inflation rate accelerated to a 2.7 percent pace in February, the fastest in 16 months, after food prices climbed and industrial production rebounded. Pundits are now worried that China's corporate earnings growth might peak in the first quarter due to the low base last year and rising costs. The biggest concern for investors has been the risk of inflation, of overheating and tightening. The Shanghai Composite's retreat has sent valuations falling by 23 percent to 29 times reported earnings from last year's high of 37 times in August. Despite the frothy valuations, earnings at listed Chinese companies rose about 18 percent last year. China's new lending fell in February from a month earlier after the unprecedented record expansion of 9.59 trillion (\$1.4 trillion) in 2009. The government this month ordered 78 state-owned companies to exit the real estate business and raised the deposit requirement to increase costs for developers and cool the real estate market. China launched its long-awaited trial program for margin trading and short selling in March. Only six brokerages are participating in the trial though. We have concern about the movement to margin trading by Chinese investors. Most Chinese investors are probably unfamiliar with riskier margin trading and short selling. We hope this new element will not accelerate risk within the Chinese markets.

SECTOR DATA

S&P Sector	2010 YTD Return
Industrials	12.91%
Financial	11.55%
Consumer Cyclical	10.90%
Consumer Staples	6.89%
Healthcare	4.49%
Energy	1.81%
Technology	1.76%
Utilities	-2.11%
Telecom	-3.94%

**Highlighted areas of our over weighted sectors*

SIPCO PORTFOLIO REVIEWS

U.S. GROWTH LEADERS

The SIPCO growth portfolio posted a 2.0% gain in the first quarter versus a 4.6% gain for the benchmark growth index Russell 1000 Growth. Performance for the quarter was hindered by a higher level of cash along with a more defensive posture versus the stock market. The largest gainers in the first quarter came from the consumer sector, with Las Vegas Sands advancing 40% and the Gap rising 11%. Technology stocks also rose, with our selections doing well including Time Warner Cable (up 28%), Apple (up 10%), and AOL (up 10%). Google was our poor performer in tech, as the companies' decision to pull out of China had negative impact on share price. Two financial stocks did well in the quarter, Bank of New York and PNC Bank. These stocks both advanced by 10%. On the negative side, our energy stocks followed the sector with poor returns. Devon Energy cascaded 12%, Exxon Mobil dropped 3%, and Schlumberger fell 2%. Within financials, National Bank of Greece fell 18%. During the quarter, we made one primary change. We sold Accenture and purchased Coca-Cola. Accenture had reached our price target after advancing by 35% in the past twelve months. Coca-Cola has only appreciated by half as much during the past year. Coca-Cola (KO) is the world's biggest brand and largest manufacturer of soft-drink concentrate and syrups. It enjoys a 50% share of the world's carbonated soft drink market (and 44% share of the US market). Coke continues to grow its portfolio of non-CSD brands as consumers' diets shift. Over 75% of its profits are derived outside of the US. The firm has recently agreed to purchase its bottlers, a move that we feel will accelerate earnings. Coke's acquisition of its bottling and distribution activities in North America should also give it a closer relationship with retailers and prevent PepsiCo from gaining a competitive advantage in a fiercely contested market. The company's products represent only around 3% of the estimated 50 billion beverages that are served every day around the world, creating global growth opportunities. The company is very financially stable while paying a 3.2% annual dividend yield. We feel Coca Cola is worth \$70 a share within eighteen months, fifteen dollars higher than the current quote. We are currently maintaining a large cash position of 10% in the growth portfolio as we expect better buying opportunities to present themselves later this year.

U.S. VALUE LEADERS REVIEW

The SIPCO value portfolio had a quarterly return of 4.1% versus a 6.7% gain in the Russell 1000 Value Index. As with the growth portfolio, the value had a large percentage of money devoted to energy stocks. Thus performance was behind the average as the energy stocks had a difficult quarter. Value holdings Total SA fell by 9%, Royal Dutch Shell dropped 6%, while Chevron was down by 3%. We still feel very positive about the energy sector, as we feel that the price of oil will continue upwards towards \$100 a barrel by year end. These firms also pay hefty cash dividend yields, some as high as 6%. Verizon was our other big loser, dropping over 5% in the quarter. On the winning side, our consumer names did very well. Ford Motors led the pack with a strong 35% advance. Hershey Foods rose by nearly 20% as rumours of a takeover by Nestle continued to be a hot topic. Within the healthcare sector, we had several winners including Wellpoint (up 10%), UnitedHealth (up 8%), Bristol Myers (up 7%), and Merck (up 4%). We are optimistic about the healthcare sector in general, as we believe the current bill passed by Congress will increase overall spending. Although the sector cut deals with our politicians in concern to cuts, the

addition of 35 million uninsured to the system will result in higher spending for hospitals, drugs, and medical supplies. We remain committed to a higher than average exposure to this sector. Our value stock portfolio maintains a large dollar weighting in high dividend stocks. The average dividend yield for the portfolio is over 3.5%. The portfolio also maintains a double digit position in cash. We expect energy stocks to rebound in the second quarter along with utilities. Our lone utility holding in the portfolio is Southern Company. We are examining several other utilities that maintain good growth prospects along with 5% plus yields.

ABSOLUTE RETURN HEDGE REVIEW

The absolute return hedge portfolio showed a loss of 7% in the first quarter. This was the worst return for the hedge portfolio in over three years. As always, please note that this fund looks much different from our other fund and stock funds, as you are invested in this fund primarily to provide added diversification away from the stock market. We had started the year believing the stock market had reached an intermediate top. We purchased the DXD and FXP funds, which advance if the stock markets in the U.S. and China fall. We have not been correct however, as the stock markets have continued to press forward. We are still of the belief that the stock market will struggle this year as the housing market continues to wobble while interest rates move higher. We expect the ten year Treasury bond to advance in yield from under 4% today to over 5% by the end of the year. This should put a lid on stock prices, as bond yields compete for investors' cash. This would also severely impact mortgage rates, which in turn would put more pressure on the housing market. We are of the opinion that the housing market will once again see price depreciation once the housing credits expire in May. Outside of market direction, we are paying close attention to the price of gold. If gold can break through the \$1200 an ounce rate this year, we feel that gold could advance to as high as \$1500 by the end of the year. We would then be buyers of gold. We also continue to like natural gas. Natural gas is the cleanest burning fossil fuel. Because the combustion process for natural gas is almost perfect, very few byproducts are emitted into the atmosphere as pollutants. Worldwide demand for natural gas has been growing at an average rate of nearly 3% a year, compared to oil's 1.7%. China's gas consumption is forecast to triple over the next 12 years, India's to double. Yet between them they have less than 2% of global reserves. We currently maintain a position in the UNG natural gas fund.

ECONOMIC REVIEW

Fourth-quarter 2009 GDP growth was 5.7% at an annualized rate, a stronger performance than the 4.7% expected by forecasts and the 2.2% annual rate increase in the third-quarter 2009. A slower pace of inventory de-stocking added 3.4 percentage points to the overall growth rate. However, final sales were also firmer than expected and increased at a 2.2% pace. The report does not alter our view that positive growth will be maintained going forward. Even though the economy left 2009 on a firmer note, for the year as a whole, output dropped by 2.4%, the first annual contraction since 1991. The first estimate of GDP growth indicated increases in most major expenditure categories. Consumer spending growth was slightly firmer than expected with strength in spending on non-durables and services offsetting

the marginal slide in spending on durables after the cash-for-clunkers induced surge in the third quarter. Business investment unexpectedly rose by 2.9% because of stronger spending on equipment and software, which more than offset the 15.4% annual rate slide in spending on structures. Housing investment increased, and although the pace was slower than anticipated, it marked the second-consecutive quarterly gain. Exports rose at an 18.1% annualized rate while imports rose by a slower 10.8%. On balance, net exports added 0.5 percentage points to output in the quarter. Government spending fell marginally.

Annualized quarterly growth in the fourth-quarter core PCE deflator, the key inflation measure in the GDP report, was 1.4%, higher than the 1.2% rate recorded in the third quarter. The stronger growth in the fourth quarter confirmed two-main developments. First, the consumer, after being in hiding the previous-six quarters, re-emerged in the second-half of 2009 with spending increases recorded in both quarterly reports. This was a reflection of rising confidence that the recession was ending, the effect of government programs, and a very low interest rate environment. Going forward, we expect that consumer spending will remain positive but that increases will be moderate as the hangover from the buying binge in previous years constrains activity. Residential construction activity also picked up for a second-consecutive quarter. These two factors contributed to final domestic sales rising 2.2% and 1.5% respectively in the final-two quarters of 2009. The improvement in the second half of the year, however, was not enough to prevent an overall decline in 2009 for domestic final sales of 1.7%. The other development was the slowing pace of inventory cutbacks that took place in the quarter. In fact, this was the main source of strength in the quarterly increase and accounted for 3.4 percentage points of the 5.7%. The large inventory correction that took place during the recession appears to be petering out as businesses anticipated the end of the economic downturn. As for employment levels, on April 2 it was announced that payrolls increased 162,000 (*consensus: 184,000*) while the unemployment rate remained at 9.7%. Manufacturing payrolls were up for the second time in a row; this time by a more solid 17,000. This, however, is in contrast to the ADP Employment report, which in late March reported that the manufacturing sector shed 9,000 jobs while the goods industry lost 51,000. One positive aspect of the report is both January and February payroll numbers were revised up by a cumulative 62,000. January even turned positive. On the downside, the unemployment rate remained at 9.7%. The number of long-term unemployed continues its relentless increase and is now at 44.1%, up from 40.9%. In other words, 44.1% of all unemployed workers have been so for 27 weeks or more.

The strengthening growth of GDP is clearly positive news from our Federal Reserve Bank's perspective, and its assessment of the economy's prospects was mildly more upbeat in this week's statement accompanying its rate decision. The high persistent unemployment rate, however, means that even though economic conditions are starting to improve, there is little urgency for policymakers to increase interest rates, and they remain focused on removing the stimulus coming from the less-traditional programs. We expect that the economy will continue to grow in the second quarter of 2010 although it will likely be at a slower pace than in the fourth quarter because the outsized support from the inventory component is unlikely to be sustained. We look for the economy to grow by about 2.2% in both the first and second quarters of 2010 and forecast that the current 0% to 0.25% range for Fed funds will be maintained until labor market conditions improve and the yawning output gap has started to close. We are of the opinion that we will have a low Federal Funds Rate (FFR) for a long time; this report does not change our belief in that regard. Despite these lackluster economic indicators, we feel confident in a rise of longer term rated yields to 5%. This is primarily

due to the demand equation of bonds. Our Treasury Department cannot continue to issue an inexhaustible amount of bonds to the public without higher offered rates.



MARKET OUTLOOK

Our market direction call for 2010 has been wrong so far. We speculated that 2010 would be much like the years 2004, 1994, and 1977. In each of these years, the stock markets struggled to add upon gains of the previous larges gains. Although none of these years offered investors large declines, the stock markets simply stagnated for most of the year. We still feel this is the most logical path for the market and thus we are remaining cautious on the capital markets. We are continually concerned about the viability of the economic recovery, especially housing. We are also cognizant of the global economic concerns including Greece, Ireland, and Eastern Europe. We could easily have an exigent shock to the system from one of these retched states. In addition, U.S. investors have embraced this stock rally too quickly. The ratio of puts to calls on U.S. equities dropped to 0.40 on an intraday basis on March 25, the lowest level since Jan. 11. Calls convey the right, without the obligation, to buy a security at a set price by a given date. Puts give investors the right to sell. If investors buy more calls than puts, it indicates froth in the markets.

During the S&P 500's 73 percent rally from a 12-year low in March 2009, the put/call ratio sank below 0.40 on four occasions, all of which were followed by declines ranging from 3 percent to 7.9 percent. In addition, the S&P 500 stock index has gone 24 sessions without as much as a 1% correction -- the longest such streak of this bull market. Nearly 91% of stocks are straining above their 50-day averages. Financial stocks driving the latest leg up are even more overbought, with 96% of the sector above their 50-day averages. On top of that, analysts have upgraded their estimates aggressively ahead of April's earnings confessional, and the crop of buy ratings relative to sell has already reached an eight-year high. Expectations for positive earnings reports are elevated to a high degree. Although we expect first quarter earnings to be very robust, we feel these good earnings are already priced in the stock market.

Although price action in the stock market is one of the most critical factors in technical analysis, overall trading volume also is important as it tells us the conviction of the marketplace. Trading volume always tells us the conviction of

ownership. And at present, the conviction of the public to own stocks is lacking. Overall trading volume has been low for several months. This indicates that the average investor is not convinced that owning stocks is a good idea, even after a 70% plus market rally. The more volume, the more widespread the bullish mood and the more orderly the market will be, both as it rises and as it turns. Low volume does not prevent rallies, but it does make them riskier. It is another element that gives us pause in 2010.

We appreciate your continued trust and confidence. Please call with any questions regarding your portfolios.