

# SIPCO

SIPCO is an emerging investment management firm headquartered in Tampa, Florida. Our equity product capabilities span different equity styles, large-cap growth, large-cap value/core, & absolute equity management. Each product, although separate, is tied together by a common sector focus and discipline. Our unique strategies have been designed to provide our investors with above market performance over time with a sharp focus on downside risk. The regimented and fundamentally driven investment strategies offered at SIPCO are well suited for the institutional marketplace.



## QUARTERLY COMMENTARY - THIRD QUARTER 2009

### U.S. GROWTH LEADERS PORTFOLIO

### U.S. VALUE LEADERS PORTFOLIO

The rally that began in early spring gained steam over the summer. The Dow Jones Industrial Average (Dow) jumped 15 percent in the latest three months for its biggest quarterly gain since the fourth quarter of 1998 and its best third quarter since 1939. The Dow added 1,265 points in the three months from July through September, and the broader index Standard & Poor's 500-stock gained 137 points in the third quarter, leaving it up 19 percent for the year and up 56 percent from its March low. The Nasdaq composite index, which includes many of the premier U.S. technology companies, gained 15.6 percent in the quarter. Those improvements added to similarly strong returns a quarter earlier. Still, many investors are a long way from whole. It would take another three-and-a-half blockbuster quarters exactly like the last three months to lift the Dow back to its 2007 record highs, and many pundits are dubious that markets can extend their rally much further as long as unemployment remains high and consumer spending is weak. The Dow is up 48 percent from its March 9 low and up 11 percent this year, although still down 31 percent from its October 2007 record. The 28 percent gain over the past six months was the best performance since the two quarters ended in March 1987. As with the Dow, the S&P 500 index is still under water by a large margin; off 32 percent from its October 2007 high. The quarterly advance in the S&P 500 was its best quarter since 1998, when the global financial markets were recovering from the Asian financial crisis and the Internet stock bubble was expanding. Then, the stock market continued to rise until the bubble burst in early 2000. The powerful rally that started this past March came as the economy finally showed considerable signs of stabilization. Corporate profits have come in above reduced expectations, in large part due to cost cutting. These positives steamrolled concerns that consumers remain hobbled by debt, high unemployment and depressed home prices. The big stock gains followed a brutal bear market that hit hardest those companies with the shakiest balance sheets, heavy debt loads and high fixed costs. Smaller companies, as measured by the Russell 2000 stock index, advanced 19 percent in the third quarter. For the year-to-date, smaller stocks are up over 22 percent, a few percentage points more than their larger brethren.

## Gross Performance

The SIPCO **U.S. Growth Leaders Portfolio** returned 15.59% for the third quarter of 2009. This was above the return of the Russell 1000 Growth Index, which rose 13.97%

**Our U.S. Value Leaders Portfolio** had a quarterly return of 10.58% versus the Russell 1000 Value Index quarterly gain of 18.24%.

---

## Our Top Performers – U.S. Growth Leaders Portfolio

Several of our pharmaceutical and medical device firms announced earnings that were well above expectations. Our largest stock gainers in the quarter include Zimmer Holdings (up 26%), Novartis (up 23%), and Roche (up 19%). As for Novartis and Roche, these two European pharmaceutical firms benefited from strong earnings and a weak U.S. dollar. During the third quarter, we made two alterations in the healthcare sector. We sold Forest Labs as the stock advanced from \$19 to \$30 a share, meeting our price target. We then added to our spinoff position in CareFusion. CareFusion manufactures medical equipment and supplies, including pharmaceutical dispensing cabinets, infusion pumps, ventilation and respiratory products, infection-prevention supplies, and surgical instruments. We had multiple strong technology performers in the third quarter including Apple, EMC, Applied Materials, and Google. These stocks advanced 30%, 29%, 22%, and 18% respectively.

## Our Top Disappointments – U.S. Growth Leaders Portfolio

Although we had no substantial decliners in the growth portfolio during the third quarter, we did have equities that did not move up during a strong third quarter. Oracle dropped 2%, Corning fell 4%, while both Gilead Sciences and Bank of New York were off 1%. Oracle was affected by a late August financial update that was perceived as negative by the market. We still feel that Oracle offers compelling value at 12 times next year's earnings. Our Bank of New York position was felled by a poor reserve position. We feel that a third quarter update will alleviate any future fears in relation to Bank of New York's balance sheet.

---

## Our Top Performers – U.S. Value Leaders Portfolio

Performance was once again led by several oil firms including the super majors we own. As for the third quarter, every one of our energy holdings advanced. Chevron, ConocoPhillips, Marathon, and Total SA had single digit gains. Royal Dutch Shell rose over 15%, while growth holding Devon Energy advanced by nearly 25%. (over)

Outside of the energy sector, our industrial stocks excelled. Dow Chemical, 3M, and Honeywell advanced by 62%, 24%, and 20% respectively. 3M was a stock we purchased during the market abyss in March at just above \$40 a share. We think the stock has substantial further upside. Within the healthcare sector, Bristol Myers advanced 13% and Merck rose 15%. Cigna also bucked the negative HMO trend, rising by nearly 18%. We made no new additions or deletions within the value portfolio during the quarter.

**Our Top Disappointments – U.S. Value Leaders Portfolio**

The portfolio had several poor performers. HMO firms Wellpoint and United Healthcare were the top losers during the past quarter. Wellpoint dropped 7% and United Healthcare fell 2%. Both stocks were impacted by the current healthcare bill moving through the Senate Finance Committee. Although we are cognizant of the risk of a public plan becoming a viable option, we believe the odds are still in favor of the HMO companies. In any event, valuations are at an extreme level, with both firms trading below 8 times expected earnings. Our other portfolio loser was Mitsubishi Tokyo, which lost 17% due to the negative news flow in Japanese banks.

**Portfolio Additions - Third Quarter 2009**

1. **Exxon Mobil (XOM)**, was added to the growth portfolio on August 8, 2009 at an average cost of \$69.15 a share. Exxon Mobil Corporation engages in the exploration, production, transportation, and sale of crude oil and natural gas. The company also engages in the manufacture of petroleum products, and transportation and sale of crude oil, natural gas, and petroleum products. It manufactures and markets commodity petrochemicals, including olefins, aromatics, polyethylene and polypropylene plastics, and other specialty products. The company also has interests in electric power generation facilities. The stock price has fallen by 30% since late 2007, offering an opportunity for a patient investor.

**Why Purchase:**

- o Exxon Mobil has a stellar financial position with \$16 billion in cash, a book debt/total capital ratio of 8%, and one of the few AAA credit ratings.
- o Natural gas will be a major energy component over the next couple of decades, as carbon limits become mandated. ExxonMobil is nearing completion of a \$30 billion project to develop the world's biggest natural gas field. Exxon Mobil will be the leading provider of natural gas by the end of the decade.
- o Exxon has paid \$36 billion in dividends and repurchased \$82 billion worth of stock, reducing shares outstanding by 20%.
- o Based upon our target price of \$80 a barrel for oil, Exxon Mobil trades at near 10 times expected 2010 earnings.

Our investment committee members are a dynamic group of experienced professionals, each with significant financial and management experience. This group includes a former health care financial analyst, european equity manager, accounting firm auditor, and military officer.

COMMITTEE MEMBERS:

TIMOTHY J. MCINTOSH – LEAD MANAGER  
 MARGARET M. COUGHTRIE  
 KIMBERLY M. MCINTOSH  
 PAUL M. MACNAMARA

TOP TEN HOLDINGS - GROWTH PORTFOLIO

HOLDING	%
Apple	5.80
Franklin Resources	5.09
Abbott Labs	4.28
Oracle	4.02
Gilead Sciences	3.88
Genzyme	3.72
Schering Plough	3.69
Exxon Mobil	3.53
Google	3.57
Novartis	3.45

**Fourth Quarter Outlook**

We think the stock market is due for a rest. But only a short October respite. As contrarians, the eventual top of the stock market -- whenever it comes -- will be accompanied both by high levels of enthusiasm (bullishness), as well as by most investors stubbornly holding onto their bullishness in the face of any market weakness. On neither count is today's sentiment picture typical of past major market tops. It is interesting to note that as the market trended higher in September, investor surveys were turning more and more cautious. In fact, the month of September will go down in the record books as a textbook example of contrarian analysis at work. Going into the month, investors were very aware of September's reputation has the worst month of the calendar -- and bet accordingly. September proved to be a strong month for the stock markets, with a gain in the S&P 500 of over 3%. There are also several other anchors of current support for the stock market. Money supply continues to accelerate. The yield curve is also very steep and positive in its slope. This indicates a positive outlook for the economy over the next six months. Corporate mergers & acquisitions are also rebounding. There have been multiple announced M&A during this past quarter, including our own Abbott Labs. Abbott has been particularly active this year, buying medical device company Evalve Inc. for \$410 million and Visiogen Inc. for \$400 million. Abbott Laboratories then announced in September it was purchasing the pharmaceutical business of Belgium's Solvay SA for as much as \$7 billion. Technology heavyweight Xerox Corp. added to the frenzy by announcing it would pay \$6.4 billion in cash and stock for outsourcing and information-services company Affiliated Computer Services Inc. Further good news for the markets comes from another study conducted by the Investment Company Institute and Bloomberg, showing Americans are sitting on \$3.5 trillion in cash. Investors have cash equal to 73% of S&P 500 companies' net assets, the study shows, even after draining money-market accounts by 11% this year. Investors only held 62% of net assets at the peak of the bull market in 2007. The combination of increased merger activity and the giant cash horde held by investors is increasing our confidence that the stock market rally will continue until at least the end of 2009. Our last statistical data point is regarding the strength of this market and the most likely future outcome. This is especially interesting since September was the 7th consecutive positive month for the S&P 500 index. The inclination is to play contrarian and view this move as a sign of overextension. And, expect a major correction. But, as fellow FSU alumni Lee Corso would say, "Not so fast my friend". The odds for an eighth positive month are actually 12-2. The more compelling argument is the longer term picture of what follows 7 consecutive positive months. After six months, there is only one historical instance since 1950 where the stock market was lower. Thus despite the large advance for the market since March, we must examine our economic and statistical market indicators. These gauges, along with a lack of cheerleading for this current market, indicate we are not done yet with this advance. Our expectation is for a slight pullback in early October, and an additional quarterly advance of 10% as we head into 2010.

**TOP TEN HOLDINGS – VALUE PORTFOLIO**

HOLDING	%
Wyeth	4.45
Southern Co.	4.11
Hershey	3.92
3M	3.68
Total SA	3.56
Novartis	3.52
Proctor & Gamble	3.49
Intel	3.48
Chevron	3.36
Bristol Myers	3.30

**SIPCO - Strategic Investment Partners**

CORPORATE HQ  
 400 NORTH TAMPA STREET, SUITE 1160  
 TAMPA, FLORIDA 33602  
 (813) 973-1100

8000 I.H. 10 WEST, SUITE 1510  
 SAN ANTONIO, TX 78230  
 (210) 366-8030