

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 - FOURTH QUARTER 2009

U.S. GROWTH LEADERS PORTFOLIO

U.S. VALUE LEADERS PORTFOLIO

The Financial markets staged a remarkable *métempsycose* in 2009, coming back from the brink of disaster thanks to unprecedented rescue efforts by government entities around the globe. After tumbling 25.4% to a 12-year low in March, the Dow Jones Industrial Average (Dow) staged a blistering rebound to finish the year up 22.6% at 10428.05. The broader measure of stock performance, the Standard & Poor's 500-stock index, rose 26.4% to 1115.10 in 2009. It was not just stocks that advanced. Encouraged by government efforts to restart the financial system and stimulate the economy, investors who had fled from all but the very safest investments in 2008 dove back into the most volatile stocks and bonds, racking up big gains along the way. The Dow's low point occurred on March 9, when it was down 53.8% from its all-time high in October 2007. But March 9 turned out to be the official bottom in this market and from that point forward a powerful rally was initiated. The monumental climb, up 59.3% from the March low, was the fastest advance since the days of the Great Depression. The Nasdaq Composite ended 2009 an astounding 78.9% above its March low. For the year, the Nasdaq rose 43.9%. Companies in the economic sectors that had taken the biggest beating in 2008 surged, including autos and basic materials. Ford Motor shares more than quadrupled to \$10, while Freeport-McMoRan Copper & Gold more than tripled. The market benefited from the removal of the "economic collapse" possibility that was so predicted back in March. A major unknown is how the markets will fare once our Federal Reserve Bank starts draining off some of the massive amounts of cash it pumped into the financial markets to the support the economy. Investors will pay close attention to hints from the Fed as to how it's going proceed, and watching for any signs that the central bank's exit strategy is proving disruptive.

Gross Performance

The SIPCO **U.S. Growth Leaders Portfolio** returned 4.7% for the fourth quarter of 2009. This was below the return of the Russell 1000 Growth Index, which rose 7.9%. For 2009, our growth portfolio advanced 41.6% versus the index gain of 37.2%. *This marks the seventh consecutive year of outperformance.*

Our U.S. Value Leaders Portfolio had a quarterly return of 5.9% versus the Russell 1000 Value Index quarterly gain of 4.2%. For 2009, our value portfolio advanced 23.8% versus the index gain of 19.6%.

Our Top Performers – U.S. Growth Leaders Portfolio

Performance for the past three months was led by technology stocks including Corning (up 26%), Google (up 25%), and Oracle (up 19%). Technology stocks have led for most of 2009, due to superior fundamentals and a high percentage of foreign revenue. Our largest position, Apple, gained 14% as investors have started to anticipate the new tablet readers that will be launched in 2010. We originally purchased Apple during the financial meltdown at only \$93 a share. The stock now trades above \$210 a share. The healthcare sector also caught fire during the fourth quarter. Cardinal Health rose 22% and Medtronic advanced 20%. Both had positive earnings reports and fared well in the new healthcare bill being pushed through Congress. Our energy stocks were mixed, with Schlumberger rising 11% and Devon Energy going up by 10%. We added to our energy holdings by buying Hess Oil. We like Hess Oil's prospects in natural gas and exploration. Our energy stake is now up 13% of the portfolio, nearly double from last year.

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 fourth quarter. On the losing side, National Bank of Greece fell 28% as trouble brewed with Greece's national debt problem. Genzyme fell by 12% as continued problems with their manufacturing plants came to light. We expect Genzyme will resolve its plant problems in 2010 and that the firm's new product pipeline will be positively received. The portfolio now maintains a 7% cash position, which we plan to utilize if the stock market pulls back during early 2010.

Our Top Performers – U.S. Value Leaders Portfolio

As for the third quarter, healthcare stocks led the value stock portfolio. Our two HMO stocks, Wellpoint and UnitedHealth both advanced by over 30% in the fourth quarter. (*over*)

Other strong healthcare performers included Wyeth (up 30% as a takeover by Pfizer), Bristol Myers (up 15%), and Eli Lilly (up 11%). Within the energy sector, all our energy ConocoPhillips, Royal Dutch Shell, and Total SA had digit gains. In the industrial sector, 3M rose by nearly 20% as the company raised earnings expectations for 2010. Ford Motors was also a standout, rising by 38% as the company has turned the corner for profits. We think Ford can continue to recover in 2010 and the stock can potentially double from its \$10 current value.

Our Top Disappointments – U.S. Value Leaders Portfolio

The portfolio had several poor performers. On the negative side of the ledger, financial stocks dropped. We have been underweight financial stocks for most all of 2009. We continue to worry about a combination of bad debt and rising interest rates. Barclays Bank cascaded 25%, Mitsubishi Tokyo dropped 9%, and Wells Fargo fell 4%. Our only other losing stock in the fourth quarter was Hershey, which fell by 5%. We made no new additions in the value portfolio in the past three months. We maintain a high cash position, at 10%, as we have not found new value in the markets.

Portfolio Additions - Fourth Quarter 2009

1. **Hess Oil (HES)**, was added to the growth portfolio on November 9, 2009 at an average cost of \$57.15 a share. Hess is an integrated oil company involved in exploration and production on several continents and refining and marketing primarily on the U.S. East Coast. In 2008, year-end proven reserves totaled 1.43 billion barrels of oil equivalent and daily production averaged 381,000 barrels of oil, of which 70% was pure crude. Hess has the capacity to refine more than 280,000 barrels a day and has about 1,366 retail outlets scattered throughout the Eastern United States.

Why Purchase:

- o Hess has a stellar financial position with a book debt/total capital ratio of 19%, and an above average dividend yield.
- o Hess' long-term prospects have improved after new discoveries in Australia, Libya, and Egypt in 2008. Prospects in the emerging Bakken Shale gas field in North Dakota and projects in offshore Equatorial Guinea, Malaysia, and Thailand also offer longer-term growth potential.
- o The firm's 40% interest in an offshore Brazil block just south of Petrobras' major Tupi discovery has the potential to accelerate earnings during the next decade.
- o The management team at Hess is well regarded and most importantly has a large degree of equity exposure. John Hess, son of the late founder, has been chairman and CEO since 1995 and has more than 20 years of experience at Hess. Executives and board members control 12.7% of Hess' stock.

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	6.30
Exxon Mobil	4.62
Abbott Labs	4.28
Oracle	4.21
Zimmer	4.01
Google	3.88
Gilead Sciences	3.59
Novartis	3.46
Genzyme	3.39
Accenture	3.32

2010 Outlook

In a recent St. Petersburg Times article I was asked my thoughts on the New Year. I informed the reputable publication that my expectation was for single digit returns. How did I come to that conclusion? Naturally, statistics! Although statistics, like the January effects, are a minefield of half-truths, it is the only method I can rationally utilize for some type of window to the future. Let the other guys follow the lunar cycles! In examining the critical elements for prognostication, I found two key items of worthy discussion as we venture into 2010.

1. The stock market has rallied by nearly 70% since the March intraday bottom of 666 to the intraday top of 1132.

In examining history, there are only a handful of instances in which the stock market rose so far so fast. Previously, two instances stand out. In the late 1930s, the U.S. fell back into recession in 1937. This recession followed a big economic recovery from the depths of Great Depression. The recession, sometimes called the Roosevelt Recession, was a temporary reversal of the 1933 to 1936 economic recovery. The recession had a large impact on the capital markets with the Dow Jones Industrial Average falling 53% from the 1937 peak. The Dow Jones Industrial Average bottomed on March 3, 1938 at a reading of 97.46, and then rallied for 30 weeks up to a high of 158.41 for a 63% gain. The next copious rally followed the turbulent markets of the early 1970s. At the bottom on Dec. 6th, 1974, the Dow Jones Industrial Average was at 577.60 and the market had fallen 46% over two calendar years. The list of reasons to not invest in stocks sounded very familiar. Oil shortages and inflation psychology ruled the day. The banking system lacked liquidity. War was feared in the Middle East. Interest rates had soared to double digit rates. The President (Richard Nixon) had resigned in disgrace in August and the last helicopter to leave the U.S. Embassy from Vietnam in 1974 has been memorialized in the movie, "Good Morning Vietnam". But that stock market low was followed by a 75 percent rally. In each of the two cases above, the economy did recover strongly, but the stock markets zig-zagged. In 1938, the market fell nearly 30% after the market highs, then rallied by 31%, then fell again by nearly 40%. In 1975, a 27% sell off followed the large gains. Then a 38 percent rally occurred, followed once again by a 24 percent sell off. The common occurrence; stops and starts in a recovering economy combined with a digestion phase of the large stock market gains that occurred earlier. We feel as we enter 2010, the stock market has discounted much of the positive data of the economy.

2. Leadership in the transportation average is tiring (A Dow Theory Negative)

Indeed, the Dow Jones Transportation Average stalled about three weeks ago and its performance, relative to the Standard & Poor's 500 is poor. Two large firms in this index, Federal Express and Burlington Northern, have just reduced earnings outlooks. We follow the transportation average closely as it gives an early indication to how the lubricants in the economy are performing. When two large transportation firms struggle, we become more cautious about the outlook for GDP, and hence the overall stock market. As a review, the Dow Theory has its origins in the writings of Charles Dow founder of the Wall Street Journal and creator of the Dow Jones Industrial Average. If the two averages, the regular Dow Jones Industrial Average and Dow Transports, act in harmony, with both reaching new highs or lows in relatively the same time period, then the price action of each was said to be confirming a strong stock market. If, however, one average went to a new high, but the other average didn't follow suit, then there was bearish divergence. This would result in the stock market topping out. If the opposite occurred, with one average reaching a new low, but the other holding above a previous bottom, then the divergence was bullish, or positive for the market. We will be watching the critical levels on the transports as we enter 2010. At present, the transport index is flashing a yellow light.

With solid evidence that enormous rallies are almost always followed by weak stock markets, we feel a single digit return for the markets is most likely scenario. However, the stock markets will most likely be prone to large ups and downs along the way. After a positive January, we suspect the transport index will roll over and the general stock market indexes with them for a sizeable correction.

Timothy McIntosh, CIO

TOP TEN HOLDINGS – VALUE PORTFOLIO

HOLDING	%
Walmart	4.85
Ford	4.21
3M	3.92
Total SA	3.88
Southern Co.	3.77
Chevron	3.71
Intel	3.50
Proctor & Gamble	3.48
Hershey	3.45
Bristol Myers	3.37

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