

SWEET SPOT FOR DIVIDEND STOCKS?

THE STRATEGIES

INCOME-EQUITY STRATEGY, pg 4

A diversified dividend-growth strategy providing high current income, growth of income, and growth of underlying principal. Stocks are high quality, high yield, and are projected to have a rising stream of income.

INCOME-EQUITY NO MLP STRATEGY, pg 4

A custom version of our Income-Equity Strategy that excludes exchange-traded Master Limited Partnerships (MLPs).

GLOBAL UTILITIES + INFRASTRUCTURE, pg 6

By focusing on opportunities in the broad, global utilities industry, this portfolio seeks to participate in the dynamic growth potential of the most important economic sector (essential services and infrastructure worldwide).

RISING DIVIDEND PLUS, pg 8

A portfolio of large- and mid-cap companies in which dividend growth is the key variable. We focus on companies with proven long-term success and special current opportunities, and incorporate technical analysis into the portfolio process. RDP should generally be considered a value/momentum strategy.

DISTRIBUTION / MERGING UTILITIES, pg 10

An opportunistic portfolio of primarily regulated local monopoly distribution utility companies with strategic and financial takeover appeal.

MLP STRATEGY, pg 11

A high-yielding portfolio (with tax-deferred income) primarily composed of pipelines and energy facilities we feel have strong prospects for growth of distributions. Revenues are derived from durable and stable business assets that generate attractive yields to the unit holders while allowing for long-term organic growth.

In the first quarter of 2009 we reviewed the history of recovering markets and the performance of dividend-oriented stocks relative to the broad market in those recoveries. Our research made the periods during this past year, when low-quality stocks were bid up by investors, tolerable if not pleasant, for we found quite clearly that expectations for high-quality dividend stocks should not be set too high in the first stages of a market rebound. After the first stage, however, high-yield stocks (and by “high yield” we mean stocks in deciles 7–9 for yield in the stock universe) are clearly one of the key places to seek excess returns. Even during the tech-centric 1990s, dividend stocks provided excess returns above the market right up until the last few maniacal years of the decade, when the melt-up of tech stocks briefly caused their relative performance to dwarf all else in existence. (See the chart on page 2.)

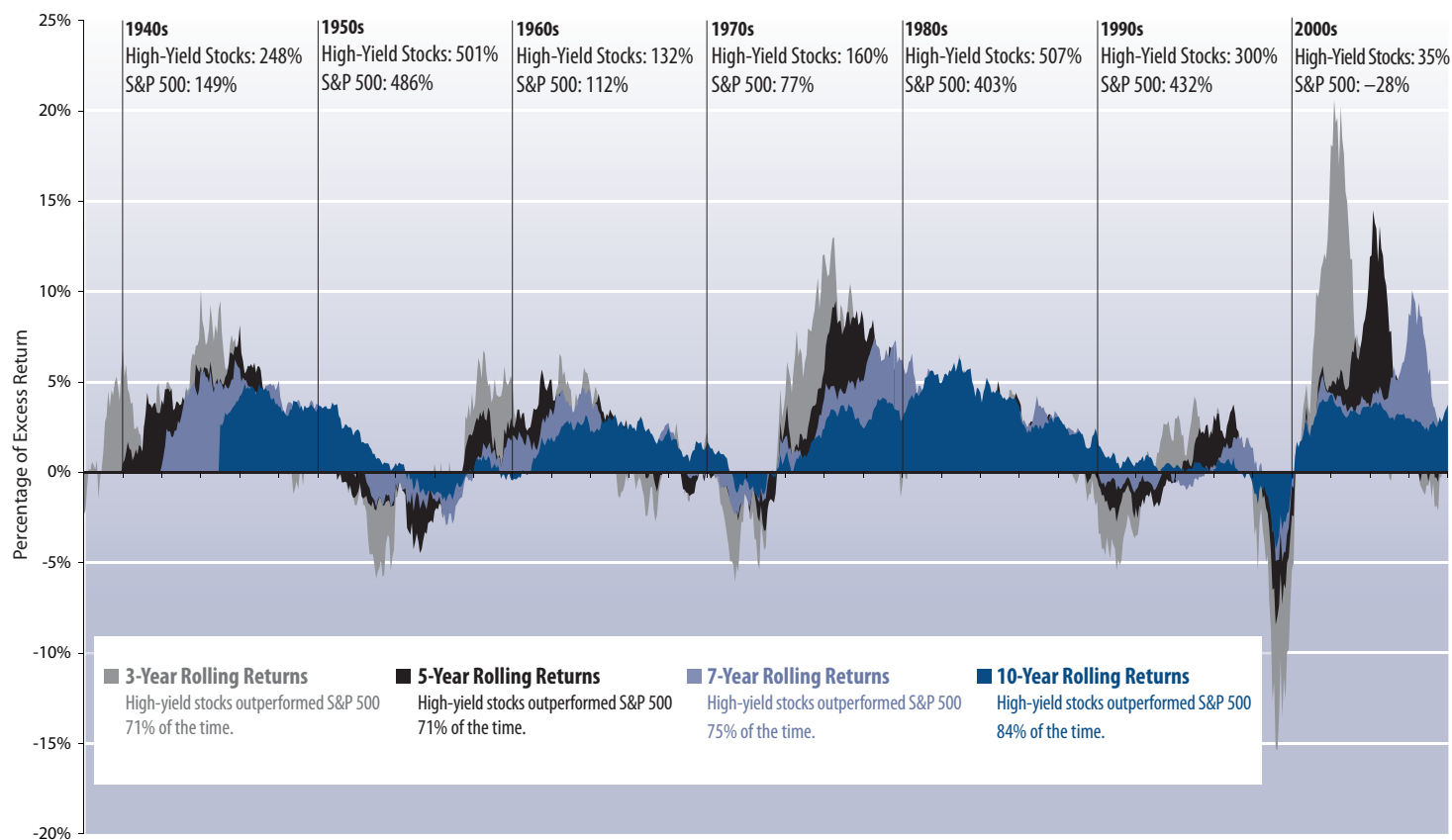
Indeed, with the single anomalous exception induced by the 1999–2000 bubble, the longer the holding period after broad market declines, the greater the advantage of dividend stocks relative to the broad market. Looking at market progress after the bottoms of 1974, 1982, 1990, and 2003, deciles 7–9 of the broad market provided a cumulative average of about 17 percentage points above the broad market over three years, with cumulative excess returns of 34%, 31%, 3%, and 2%. Interestingly, in three of those four years high-yielding stocks failed to show any excess return in the first year (and were typically a bit behind), so the subsequent period cumulative returns were even more powerful.

In any event, past performance is no guarantee of future results (and how many have suffered for willful ignorance of that maxim!) so we don’t want to be too married to historical expectations about the unfolding landscape from here, but it is indeed fortifying to us that after two quarters of eating some dust in 2009, the universe of quality (dividend-paying) companies became fully awake in the fourth quarter (ahead of schedule, if anything). When that very dust settled, each of our portfolio strategies—whether higher or lower yielding—proved thoroughly appealing on a relative basis for the full year as well.

Can we expect more? We don’t have a crystal ball, but clearly, based only on past market recoveries, the chances are good that we’ve entered the sweet spot for dividend-stock relative performance. Investors need to bear in mind, of course, that such thoughts are only based on probabilities derived from past history—which has a way of providing “twists” in each new incarnation of itself—and that such thoughts can also only really apply to relative performance. Still, when we survey the valuations of many of the stocks in our portfolios, we’re comfortable as absolute investors both short and long term. Too, in terms of what we can learn from the available history of equities, dividend stocks outperform the average stock *most* of the time, not merely beginning in year two of a recovery.

[more ▶](#)

ROLLING EXCESS CUMULATIVE RETURNS OF HIGH-YIELD STOCKS VS S&P 500 (1936–2008)*



*This chart presents a review of relative past performance for high-dividend-yield equities in relation to S&P 500 and should not be considered indicative or representative of future performance for either high-yield stocks in general or any of the investment strategies managed by Miller/Howard Investments. Returns for both high-yield stocks and S&P 500 are total returns. "High Yield Stocks" in this study comprise deciles 7 to 9 from the data set created by Eugene Fama and Kenneth French called "Portfolios Formed on Dividend Yield," in which they separate stocks into deciles based on their dividend yield. Their file was created by CMPT DP RETS using the 200901 CRSP database. We have utilized the value-weighted returns for this study. They compute D/P (in percent) breakpoints at the end of each June. We include dividend deciles 7 to 9 because we feel that profile most accurately reflects the composition (solely based on dividend yield) of stocks Miller/Howard Investments is most likely to utilize. More specifically, these companies have a dividend yield that is in the range of slightly better than market average to near the top decile. We omit the highest decile because many distressed stocks and outliers are commonly found in the tenth dividend yield decile.

Beyond looking at history, we constantly want to revisit the basic premise of our dividend-oriented investment, and take comfort in the principles that have guided us through wars, recessions, terrorism, natural disasters, rising interest rates and falling, easy money, and most recently, a precipitous meltdown of the financial system. Withal, we're still here and still collecting our dividends. We think that the consistent results are built on a simple foundation: We are not looking for "exposure" to market indices; we are looking for good investments.

When dividends are a part of your investment portfolio, you are an income investor. And we strongly believe income isn't just a part of the investment equation, it is integral to it. When an investment produces income, which is a real return (not a promise), and which is always positive, that income can be spent, or re-invested in more stock. Over

time one share with re-invested income becomes two, and then three, and then four, world without end. And if the income increases, over time the value of the instrument producing that income—the equity interest—should increase commensurately (all other things being equal). This "internal compounding" is a powerful force whether an investor re-invests the income or not, and it persists no matter whether the market is rising or falling. Hidden in the forest of everyday debate, discussion, and stargazing, too many investors lose sight of this fundamental compounding process as they become mesmerized by the ups and downs of the averages and the next great story.

The dynamics of income investing are easier to understand when comparing the process to owning rental property (everyone knows that's income investing!). Like dividend stock investors, rental property investors are

buying a stream of cash flow, and paying a certain multiple for it. The income stock investor is not only buying the stream of cash flow, he or she is also *collecting* it, something like a landlord—a concrete moment that’s very important in this world that has increasingly become a huckster’s paradise. So we can think of a company and its cash flows as similar to a rental building and its cash flows.

You’d pay a certain price for a rental building based on the amount of cash it generates, cash that gets paid *to you*. You might look at some other features to determine your price as well: Is the income secure? Are there chances to increase the cash flow? Is the property well located and competitive in its segment? Is it protected from competitors in some way? Is it in the path of development? What are the chances that the owner might benefit from some additional source of value, such as mineral rights or rezoning, or technological changes, such as the need for more cellular broadcast points? For the rental property investor the issues are the same as for the dividend stock investor: What is the security of the income? What are the chances for increasing income? Are there additional sources of potential value?

Like rental property owners, dividend stock owners need to keep a strong eye on the long term, where asset values can increase as income increases. And if asset values don’t increase for a period—which can happen to both rental property and income stock investors—at least there is still the cash flow to provide positive returns (and to meet spending needs without having to sell assets). But income investors in the stock market have an edge: There are many more opportunities or different sources for income than just rents, the liquidity of the investment is much stronger—a situation that isn’t working out as expected can be exchanged for another, and best of all, you don’t have to go up on the roof with a pot of tar! You have an entire army of managers and workers all striving, when the world is working as it should, to increase your cash flow, the income that’s actually paid to you, and the ultimate value of the asset producing the income.

To us, this seems like a much saner strategy than trying to jump from trade to trade, and that’s why we do what we do. In the end, excellence in execution of the strategy makes a substantial difference. Focus and experience are required. But without a clearly defined strategy that offers both common sense and historical confirmation, investors are just dangling at the whim of daily market forces and emotions. [MFI](#)

GIPS Disclosure Information

Results are shown in US dollars. Included in the results are all unrestricted portfolios that have been managed for at least one full quarter, including those accounts no longer with the firm. Past performance is not indicative of future results. All composites contain fully discretionary accounts.

Gross and pro forma net of fees results include the reinvestment of all income. Wrap accounts are included in this composite. Gross returns for wrap accounts are stated gross of all fees and transaction costs. Gross returns for nonwrap accounts have been reduced by transaction costs. Pro forma net returns are a simulation assuming a 3% annual total fee, deducted monthly. The 3% fee includes other program fees, which may or may not be charged as assumed. The upper range for Miller/Howard Investments’ annual fee is 1%. Fees are generally based on quarterly market values determined by the custodian and may include any combination of management, transaction, custody, and other administrative fees. Wrap fee schedules are provided by independent wrap sponsors and are available upon request from the respective wrap sponsor. Actual investment advisory fees incurred by clients may vary. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account.

Miller/Howard Investments Inc. is an employee-owned, registered investment advisor specializing in multi-cap, core equity management and dividend strategies.

Miller/Howard Investments Inc. claims compliance with the Global Investment Performance Standards (GIPS®). Compliance with the GIPS standards has been verified for the period of January 1, 2000, through December 31, 2007, by Ashland Partners & Company LLP. To receive a complete list and description of Miller/Howard Investments’ composites and/or a presentation that adheres to the GIPS standards, contact Marilyn Marecek at 845-679-9166, or write Miller/Howard Investments, P.O. Box 549, Woodstock, NY 12498, or marilyn@mhinvest.com.

Annual ADV Update

If you would like a copy of our current ADV Part II, please contact Marilyn at:

(845) 679-9166

or

marilyn@mhinvest.com

The ADV will be mailed to you, free of charge.

“...we strongly believe income isn’t just a part of the investment equation, it is integral to it.”

SELECTED INDICES

	4 th Qtr 09	1 Yr
S&P 500	6.0%	26.5%
Equity Inc	5.4%	29.9%
Util Fund	5.9%	17.5%
BC Long	(5.3)%	(12.9)%
R3UTIL	6.9%	11.1%
R1000	6.1%	28.4%
R3000	5.9%	28.3%
R3000Val	4.2%	19.8%
DVY	7.5%	11.1%

S&P 500 = Standard & Poor’s Index
 Equity Inc = Avg Equity Income Fund (Lipper)
 Util Fund = Avg Utility Fund (Morning Star)
 BC Long = Barclays Capital US Treasury Long
 R3UTIL = Russell 3000 Utilities
 R1000 = Russell 1000
 R3000 = Russell 3000
 R3000Val = Russell 3000 Value
 DVY = iShares Dow Jones Select Dividend ETF

INCOME-EQUITY WITH MLPs

Sector Weights

Cash	2.3
Consumer Discr	4.0
Real Estate	4.1
Business Services	5.5
Financials	6.9
Technology	7.4
Energy	7.7
Consumer Staples	7.9
Telecom Services	8.2
Utilities	10.8
Healthcare	16.0
Pipelines	19.2

Current Yield [†]	5.0%
Proj Dividend Growth ^{††}	7.4%
Beta ^{†††}	0.7

Sector weights are taken from a representative account and are subject to change. The above data is shown as supplemental information and complements the full disclosure presentation located on page 5.

[†]Weighted average.

^{††}Proj Dividend Growth is MHI Portfolio Team's projection based on data from various sources adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

^{†††}10 Year annualized vs. S&P 500.

As noted in our Overview, dividend stocks have begun to take a more normal place at the head of the class this past quarter—right on schedule in terms of our study of the history of dividend stocks during recoveries. They are rarely first out of the gate in a rebound—that position generally tends to be occupied by the stocks that were sold the most, or perhaps one should say, sold the most irrationally. But as troubled stocks return to more reasonable valuations and as investors begin to return to equities, a single issue always arises: Which stocks will give me the best risk-adjusted return over the long term?

History has shown that the answer to that question is higher-yielding stable companies that can grow in line with the economy or a little better, and that share a portion of their current prosperity with shareholders in the form of dividends. You hear much today from commentators trying to sound grown-up and sophisticated about the “dollar trade,” or the “carry trade,” or the “materials trade,” or the “tech trade,” or the “emerging markets trade,” but all these thoughts have one thing in common: They are trades. Investors who want to jump around from one idea to another really are traders, rather than investors. To succeed, traders have to be consistently right about those many jumps. On the other hand, true investors understand that they are partners in a business. There will always be times when buyers line up for cheap or risky stocks, as we saw in 2009. But those are transient moments, and sooner

or later quality wins out. If the trends of the fourth quarter persist, “sooner or later” has become “now.”

Hand in hand with that idea goes our observation that the massively tight correlations between stocks and sectors that were evident during the decline of 2008 and into 2009 have loosened up to the point where old-fashioned stock picking is returning as a potent factor in differentiating returns. We see this at a general level in comparison to other dividend-oriented strategies, particularly dividend ETFs, whose returns seem to place them in a whole other universe. At the portfolio level we see it in a number of our utility stocks that have helped the portfolio substantially—despite the fact that utilities as a traditional “sector” measured by indices was the laggard for the year. There is still plenty of homogeneity or tendency toward high correlation within sectors, across the sectors, and across the globe. But it’s loosening up, and that’s good news for those who buy investments rather than indices.

PORTFOLIO HIGHLIGHTS

We were impressed with the diversity of stocks that contributed to our returns in the fourth quarter, as results were driven by companies in specialty real estate, mid-cap distribution utility, large-cap drug, foreign telephone, pipeline, large-cap consumer nondurable, water, fast-food restaurant, industrial services, and even semiconductor manufacturing. That’s the kind of portfolio we always seek to achieve—as much diversification as possible consistent with the

SELECTED LEADERS

CMS Energy	Favorable regulatory developments, many new fans on sell-side
Merck & Co	Large earns beat, major share repurchase, SGP merger approved
Microchip Tech	Raises guidance, earns beat, increases dividend, group strong
Unilever	Sales up, dividend increase, benefits from marketing step-up
Northeast Utilities	FERC-regulated revenues finally gaining recognition, still cheap
Alexandria RE	Raises div. 3rd quarter in a row, balance sheet restructure continues

SELECTED LAGGARDS AND SELLS

Telefónica SA	Profit-taking sell on valuation and difficult home market
Cincinnati Fin	Big earns beat, management optimistic, market apathetic
Enbridge Energy Pt	Profit-taking sell for better opportunities without tar sands problems
Kraft Foods	Replaced with INTC, dividend prospects dimmed on Cadbury deal

highest quality possible and the highest yield possible. When a stock rates high on those factors, we're interested. It doesn't have to be the cheapest in the world, though that helps too.

American Water Works' double-digit return was gratifying, since last quarter we had tempted the wrath of the Fates by calling it an "easy" investment. Likewise, CMS Energy contributed more than twice the market for the quarter and year, reaching levels we had suggested last year were in the cards (including a substantial dividend increase) almost no matter how the broader market behaved. This is not to boast—though that can be more fun than issuing apologies—but to point out how helpful a special expertise (utilities in this case, and distribution utilities more specifically) can be in generating alpha for a broad-based portfolio.

But we think the big story in the portfolio this quarter was the awakening of the large-cap pharmaceuticals. Almost unheralded, they moved decisively out of congested long-term technical bases, on the usual mix of positive and negative individual drug news flow. Interestingly, this move came just as it finally became clear that Congress would, in fact, pass some form of healthcare reform, and that among the tangled vines of an ultimate bill's final provisions two things seemed fairly clear: (1) no drug importation from Canada, and (2) tens of millions of citizens to be newly covered by health insurance. Yes, we know all about patent cliffs and generic competition and the rest of the knocks on big pharma, but we think more users of their product (here, as a result of legislation, and all over the world, as a result of economic development) is good news. We also think their bargain stock prices reflect only bad news. We've been here before, during the Clintons' failed efforts at reform, when drug stocks went down into single-digit PEs, only to rise smartly in the ensuing years. We have no problem comparing large pharma companies and their growth immanence, high cash, high yields, and steady cash flow selling at single-digit PEs to utilities with their secure revenues but limited growth selling at low-to-mid double-digit PEs. We favor utilities and understand their attractive long-term risk-adjusted-return

profile better than most, but pharma wins this beauty contest at the moment. That's why we're overweight in the portfolio and expect to remain so. Interestingly, in both cases potential M&A is always a wild card and a factor to consider in stock selection.

LOOKING FORWARD

We've been patient during the "dash to trash" phase of the market rally, and indeed suggested early last year some patience might be necessary, as what happened in 2009 second and third quarters was the most likely initial outcome in recovery. At the moment we don't have a strong view on the shorter-term overall equity picture, but so many factors point to a relative movement in favor of quality and yield—factors such as relative valuation, the scarcity of competitive yield, the current position of buy-

continued on back page

INCOME-EQUITY NO MLPs

Sector Weights

Real Estate	2.2
Cash	2.3
Consumer Discr	4.1
Business Services	5.8
Consumer Staples	7.2
Technology	7.5
Energy	8.1
Telecom Services	8.2
Pipelines	8.7
Financials	8.8
Healthcare	16.4
Utilities	20.7

Income-Equity Strategy Composite Performance
GIPS composite disclosure shown in US dollars

Preliminary	Income-Equity With MLPs		Russell 1000
	Gross*	Pro Forma Net	
Period to Date (3 mo's to 12/31/09)	8.0%	7.2%	6.1%
1 Year per annum (ending 12/31/09)	25.1%	21.4%	28.4%
3 Years per annum (ending 12/31/09)	(7.0)%	(9.8)%	(5.4)%
5 Years per annum (ending 12/31/09)	0.6%	(2.4)%	0.8%
7 Years per annum (ending 12/31/09)	6.1%	3.0%	6.0%
10 Years per annum (ending 12/31/09)	4.1%	1.1%	(0.5)%

Preliminary	Income-Equity No MLP		Russell 1000
	Gross*	Pro Forma Net	
Period to Date (3 mo's to 12/31/09)	8.3%	7.6%	6.1%
1 Year per annum (ending 12/31/09)	21.9%	18.3%	28.4%
3 Years per annum (ending 12/31/09)	(8.2)%	(11.1)%	(5.4)%
5 Years per annum (ending 12/31/09)	(0.5)%	(3.6)%	0.8%

*Gross returns are supplemental information to the pro forma net returns, which are not actual net returns but a simulation of the effects of 3% total annual fee, deducted monthly. MHI's highest annual fee as stated in our ADV is 1%.

The Income-Equity Strategy Composite contains fully discretionary accounts focusing on multi-cap, high-quality, high-yield, dividend-growth investments across the broad market, including American Depository Receipts. A custom version of this strategy, Income-Equity No MLP Strategy, excludes exchange traded master limited partnerships. For comparison purposes these strategies are measured against the Russell 1000 Index, which represents the extensive large-cap segment of the US equity universe of approximately 92% of the US market. The Income-Equity Strategy Composite received performance examination for the period of January 1, 2000, through December 31, 2007. The Income-Equity No MLP Strategy Composite received performance examination for the period of January 1, 2004, through December 31, 2007.

See GIPS disclosure information on page 3.

Current Yield [†]	4.7%
Proj Dividend Growth ^{††}	7.4%
Beta ^{†††}	0.9

Sector weights are taken from a representative account and are subject to change.

The above data is shown as supplemental information and complements the full disclosure presentation located on this page.

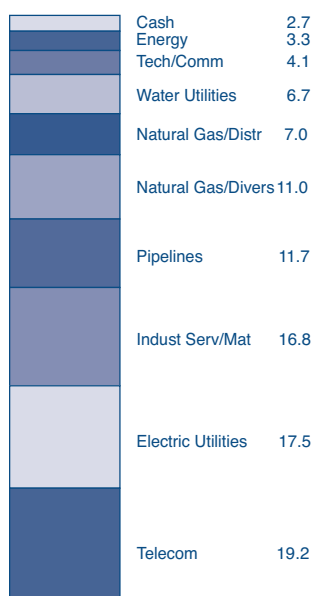
†Weighted average.

††Proj Dividend Growth is MHI Portfolio Team's projection based on data from various sources adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

†††5 Year annualized vs. S&P 500.

GLOBAL UTILITIES + INFRASTRUCTURE

Sector Weights



Current Yield [†]	2.9%
Proj Dividend Growth ^{††}	7.5%
Beta ^{†††}	0.8

Sector weights are taken from a representative account and are subject to change.

The above data is shown as supplemental information and complements the full disclosure presentation located on this page.

[†] Weighted average.

^{††} Proj Dividend Growth is MHI Portfolio Team's projection based on data from various sources adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

^{†††} 10 Year annualized vs. S&P 500.

Because our holdings are much broader than traditional utility indices, it stands to reason that our portfolio would have a relative advantage when stocks in general have been buoyant. And that has been the case this year, by a very large margin. But in the fourth quarter both utilities and the broader market performed well, and we were still able to deliver alpha, with no particular sector-based assistance. Indeed, while no analyst in his or her right mind would “benchmark” this portfolio to an index of larger scope such as the S&P 500—and to be sure there would be plenty of “tracking error” if one did so—we have proposed for nearly two decades that our asset-based, high-cash-flow kinds of companies (many of whom are government-protected local monopolies) are simply better investments than the chaotic mix of products, services, random balance sheets, and erratic cash flows that are the facts underlying the imaginative construct that most investors create when they think of “The Stock Market.” Most would agree that our companies deal in essential services. What does that make all the rest?

We continue to assert that superior risk-adjusted returns are what sensible investors should be seeking, rather than a fat slice of a pie chart that has been fabricated somewhere in a glass tower whose windows don't open. We would point out that gross returns of our strategy have outpaced the S&P 500 as of Dec. 31, 2009, for the following periods (annualized, periods ending): 1 year, 3 years, 5 years, 7 years, 10 years, 13 years, 15 years, and since inception at 18 years, and every annualized measuring period in between. There's a kind of quiet power in real assets.

PORTFOLIO HIGHLIGHTS

Perhaps the published analysts believed that in a slowed-down economy we would be turning off the lights, turning down the thermostat, and cutting short our phone calls, for nearly every stock in our portfolio beat earnings expectations in their quarterly reporting. We've rarely seen such uniformity of better-than-expected performance, and while it may indeed reflect excessive pessimism among the estimators, the fact remains that in troubled economic times essential services are the last to go (by definition!), and whatever the degree of previous selling in these stocks it was likely unwarranted. Business has been good: We had 24 dividend increases from 21 stocks this year (there was one anticipated late-year cut from already low-yielding El Paso, to generate investment funds, not due to operating or financial stress).

We increased our position in American Water Works up to maximum purchase weight (5%) once it was clear that the exit of RWE would complete, and we expected a dividend increase as a consequence, which did eventuate. Late in the quarter we added Shaw Group, an engineering and construction enabler to the utility industry as well as various other industries. We also took what we think of as trading positions in two stocks that are a bit racier than our norm but that appeared well positioned to us. American Superconductor has never really been able to capitalize on its superconducting wire technology, but while waiting for the future to arrive they have become a major factor in power handling and control

Global Utilities + Infrastructure Composite Annualized Performance

GIPS composite disclosure shown in US dollars

Preliminary	4QTR09	1 Year	3 Years	5 Years	7 Years	10 Years	13 Years	15 Years	18 Years
Global Utilities + Infrastructure (Gross)*	7.6%	31.9%	0.1%	7.5%	10.6%	4.5%	7.5%	9.3%	8.6%
Global Utilities + Infrastructure (Pro Forma Net)	6.8%	28.2%	(2.9)%	4.3%	7.4%	1.4%	4.3%	6.0%	5.4%
S&P 500	6.0%	26.5%	(5.6)%	0.4%	5.5%	(1.0)%	5.0%	8.0%	7.8%
Russell 3000 Utilities	6.9%	11.1%	(4.6)%	3.3%	7.3%	(3.8)%	2.7%	**	**

*Gross returns are supplemental information to the pro forma net returns, which are not actual net returns but a simulation of the effects of 3% total annual fee, deducted monthly. MHI's highest annual fee as stated in our ADV is 1%.

**Precedes the Russell 3000 Utilities Index.

The Global Utilities + Infrastructure Composite (known as Better Than Bonds/Utilities prior to July 1, 2008) contains fully discretionary accounts. By focusing on opportunities in the broad, global utility industry, this portfolio participates in both the stability and the dynamic growth of the most important economic sector. For comparison purposes this strategy is measured against the Russell 3000 Utilities index, which comprises over 200 utility stocks that are included in the Russell 3000 index. We make no claims that our portfolio will track the index closely. In some charts and tables we show the S&P 500 index to give investors some measure of comparison to a broad market index. See GIPS disclosure information on page 3.

SELECTED LEADERS

Akamai Technologies	Earnings & revenue beat, increased guidance, system expansion
ONEOK	Large earnings beat and raised guidance, higher margins
ITC Holdings	Increased guidance, market awakens to transmission prospects
NiSource	Earnings beat, better gas segment, EPD says wanted to acquire
Southern Union	Results in line, major Florida pipeline joint venture approved

“There’s a kind of quiet power in real assets.”

SELECTED LAGGARDS


Calgon Carbon	Import rulings a slight negative, beats on revs and earns
Veolia Environment	Profit-taking from Oct high, economy hurts waste business
China Mobile	Invest concerns about competition, esp in 3-G, still cheap
Fluor Corp	Slight rev and earns and backlog miss, but contracts keep coming
General Cable	Guides down—economic headwinds, wire and cable demand low

for alternative energy technologies such as wind farms, which basically cannot function without AMSC infrastructure. Now it’s earning money, and there’s a potential lottery ticket here in the form of its participation in the Three Amigas interconnect and transmission project in New Mexico, which, if approved, could be a mega-scale opportunity. A-One is a new listing but one of the leaders in lithium battery technology. When the stock dropped sharply back to its IPO price—despite receiving stimulus funding as well as participating in utility-scale storage proposals—we joined Warren Buffet as holders, at least for the moment, buying near the first trade post-IPO price.

We funded our sells by reducing NV Energy, the old Sierra Pacific Resources, as their key Las Vegas market continues to struggle (and the newest regulatory noises are dissonant), trimming several items due to weight or performance, and selling Telefónica SA. TEF has been a good one for us, but its home market (Spain) is experiencing disastrous economic conditions and the stock had risen from undervalued (relative to mature global telecom providers) to slightly overvalued. We’ll be interested again at a lower price. At the end of the quarter we sold Itron at a 52-week high. We were a little sorry to let it go, but it was technically overbought and timely for profit-taking at 25 times next year’s estimate. That valuation wouldn’t be so scary in a stock with this story (and theoretically about to benefit from a great deal of stimulus spending), but

there are many anecdotes now about consumer push-back with regard to smart meters, and our concerns centered on push-outs of implementations as the stakeholders’ grievances and the facts get sorted out. Here again, we’ll be interested at a price that offers a bit more margin of safety.

LOOKING FORWARD

As we noted last time, there are plenty of issues in Washington around environmental legislation, and in fact, it looks like cap-and-trade has lost its cap for a while. We continue to maintain the portfolio as we always have, without much emphasis on the potentials inherent in new legislation, and we continue to think our holdings are modestly priced—as noted above, we’re more than ready to sell when valuations exceed our standards. One potential wild card: As a group the major utilities far underperformed the broad market in 2009. It’s quite possible that investors held back due to the uncertainties surrounding legislation. In 2010 either those uncertainties will be resolved in a bill (doubtful in our view) or they will fade as any threats become less imminent. Too, should the economy improve, the business of conventional utilities would improve in tandem. And, like most of corporate America, they are already as lean as they can be—so a better economy might lead to surprising profit gains. We won’t be buying the large-cap electrics, but there’s a reasonable chance that they may set a more positive tone for the whole sector in the year to come. 

RISING DIVIDEND PLUS

Sector Weights

Cash	0.4
Consumer Staples	2.4
Energy	6.8
Consumer Discr	9.0
Basic Materials	9.3
Industrials	9.4
Financials	14.4
Healthcare	19.0
Technology	29.3

Current Yield [†]	1.7%
Proj Dividend Growth ^{††}	14.4%
Beta ^{†††}	0.9

Sector weights are taken from a representative account and are subject to change. The above data is shown as supplemental information and complements the full disclosure presentation located on page 9.

[†]Weighted average.

^{††}Proj Dividend Growth is MHI Portfolio Team's projection based on data from various sources adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

^{†††}5 Year annualized vs. S&P 500.

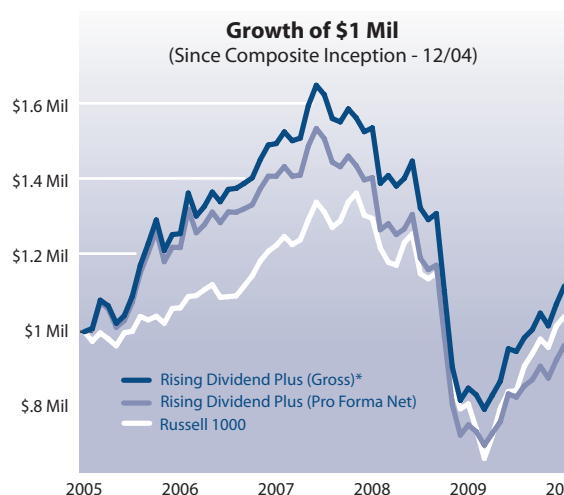
We had a solid fourth quarter and year in this strategy, with annual returns among the highest for any dividend-oriented approach. For both time frames returns were notably broad-based, and even the stocks that weren't so helpful retain solid fundamentals and leadership potential. We might have held too much in the way of quality names for a market such as was seen in 2009, but it didn't really hinder performance, and we are well situated for what we expect will be a more discerning environment going forward.

PORTFOLIO HIGHLIGHTS

Abbott Labs reported better-than-expected earnings and raised guidance. Management noted they expect "double-digit EPS growth" in the coming years, "year in and year out." The stock has been doing well of late, but given the uncertain nature of potential economic progress in this world, we wonder if a PE of about 13 on next year's management-guided estimates fully reflects the merits of this company. Well, we don't really "wonder." It is cheap, indeed.

AmerisourceBergen is among the first of the unduly low-valued healthcare sector stocks to really feel the embrace of bullish investors, gaining roughly 20% on the quarter and roughly twice that on the year. Perhaps signaling upward guidance that was soon to follow, the company raised its dividend for a second time in 2009, this time by 33%. One element we like is that the CEO's pay rose only 3%—shareholders first, the way it should be.

Just as the stock had threatened to escape a long trading range in (in our opinion) persistent undervalued territory, Intel received notice of a Federal Trade Commission action against it for competitive and antitrust violations—a fate that seems to await any technology company that comes to dominate its field. The FTC alleges that INTC has engaged in anticompetitive marketing practices ("If you buy theirs, you can't buy ours") and designed key software to put competitors at a disadvantage. We can't pass judgment on the facts under review since they're not fully



*Gross returns are supplemental information to the pro forma net returns, which are not actual net returns but a simulation of the effects of 3% total annual fee, deducted monthly. MHI's highest annual fee as stated in our ADV is 1%. The above data is shown as supplemental information and complements the performance disclosure located on page 9.

disclosed, but we can say from substantial prior experience evaluating FTC claims that this one has been posed in a kind of wimpy way. They're not even seeking money damages, just a change in behavior. Oddly, a month prior to this announcement the company settled all claims of antitrust issues with Advanced Micro Devices for a modest sum and an agreement to change business practices. We would suggest that this FTC matter is not a big legal bump. Meanwhile, the company has been beating earnings expectations, guiding upward, and has increased its dividend by 12.5%. We're fading the allegations, though we'd look again if the Justice Department became involved.

We replaced Anadarko Petroleum with Noble Drilling. APC had risen out of our valuation range, and it has not been higher since we sold, despite a strong broad market and strong natural gas sector. We favor deep-water drillers as the most attractive segment of the energy sector now, and bought NE on a positive confirming technical pattern.

We bought Comcast after it won a transformational deal—though without overpaying, in the view of most observers—in which it will take control of NBC Universal, giving it a strong content arm to complement its extensive distribution network. We had thought it a cheap stock—and it was on our radar screen before the deal

SELECTED LEADERS

Corning, Inc	Earns and revs beat. Gimme that LCD widescreen!
Visa, Inc	Earns and revs beat, 19% dividend increase, \$1 billion buy-back
Blackrock, Inc	Earns and revs beat, BGI acquisition offers upside, getting pricey
Oracle	Earns and revs beat, guides up, Sun deal likely, dominates industry
Xerox	Increased weight on technicals, ACS deal proceeds

SELECTED LAGGARDS AND SELLS

Valmont Inds	Sold, guides revs down, needs highway bill and better util biz
Bank NY Mellon	Exits TARP and other gov programs, ??'s about CEO leaving
Nokia	Sold awaiting smart-phone catch-up, dividend at risk
Cooper Tire & Alcon	Profit-taking sells, continue to hold moderate weight

“Since this strategy is our most market driven, we remain alert for both short- and long-term opportunities and risks.”

was announced—so this “settlement” of the content vs. distribution controversy at a reasonable price only made the stock more appealing in our view. Too, we have done proprietary research on an anomaly in which acquiring companies making substantial deals demonstrate *increasing* stock prices on the news, rather than the declines one would expect due to arbitrage or transaction cost disagreement. Such stocks tend to durably outperform stocks in general.

LOOKING AHEAD

Because visibility is so much less certain than back in the “old normal,” we need to be more responsive to both economic and market conditions than we might prefer, and as we noted last time, we need to remain flexible. This might entail holding larger-than-normal transitional cash, among other things. We thought this posture might obtain last quarter, though in the end, reasons for change didn’t materialize. Still, since this strategy is our most market driven, we remain alert for both short- and long-term opportunities and risks. Right now our best candidates are a little smaller and a little more obscure than what’s normally seen in this portfolio, and we still have quite a few stocks whose technical overbought condition can justify some profit-taking. Perhaps more of the changes we expected to make last quarter are in the offing for the upcoming period.

Last year roughly 60% of our stocks raised their dividends (an off year for us but a great year compared to the broad market) an average of 14%, somewhat skewed upward by ABC’s two big increases. There were no dividend cuts. We hope to return to double-digit increases for the whole portfolio, not just the majority of it, in 2010. [WFI](#)

Rising Dividend Plus Composite Performance			
GIPS composite disclosure shown in US dollars			
Preliminary	Gross*	Pro Forma Net	Russell 1000
Period to Date (3 mo's to 12/31/09)	6.8%	6.0%	6.1%
1 Year per annum (ending 12/31/09)	31.6%	27.7%	28.4%
3 Years per annum (ending 12/31/09)	(9.2)%	(11.9)%	(5.4)%
Since Inception (ending 12/31/09)	2.3%	(0.7)%	(0.8)%

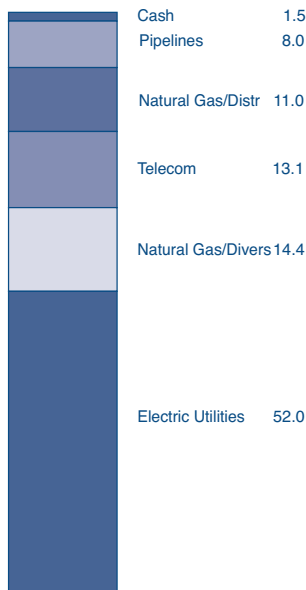
*Gross returns are supplemental information to the *pro forma* net returns, which are not *actual* net returns but a simulation of the effects of a 3% total annual fee, deducted monthly. MHI’s highest annual fee as stated in our ADV is 1%.

The Rising Dividend Plus Composite contains fully discretionary accounts, is a mid- and large-cap core strategy focusing on companies in which dividend growth is the key variable. For comparison purposes this strategy is measured against the Russell 1000 index, which represents the extensive large-cap segment of the US equity universe of approximately 92% of the US market.

See GIPS disclosure information on page 3.

DISTRIBUTION / MERGING UTILITIES

Sector Weights



Current Yield [†]	3.8%
Proj Dividend Growth ^{††}	5.0%
Beta ^{†††}	0.6

Sector weights are taken from a representative account and are subject to change.

The above data is shown as supplemental information and complements the full disclosure presentation located on back page.

†Weighted average.

††Proj Dividend Growth is MHI Portfolio Team's projection based on data from various sources adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

†††10 Year annualized vs. S&P 500.

We'd been suggesting that our gains earlier in the year were sustainable and that the major utilities averages could set a better tone after having lagged. Both proved true, and our portfolio of mainly local monopoly-regulated local distribution companies rose to market leadership for both the quarter and the year. While 2009 may have been dominated by lower-quality stocks, the right higher-quality issues had no problem delivering, even without the M&A activity in whose path we hope to reside.

PORTFOLIO HIGHLIGHTS

We had very little transactional activity during the quarter. MetroPCS reported poor results, and at the same time new competitors such as AT&T announced a move into the prepaid wireless business, a development we thought would be negative for PCS. We sold the stock and redeployed the funds into our existing holding Telephone and Data Systems—the most attractive remaining independent wireless-centric phone company—to good effect, as the stock subsequently rose over 10% to quarter's end.

That was it for our transactions. Somewhat astonishingly, about two-thirds of our portfolio showed double-digit gains for the quarter. Recent purchase Integrys intensified its process of divesting its racier businesses, and investors were happy to re-enter a more conservative business model, bidding it up nearly 20%.

CenterPoint led the portfolio with a nearly 25% gain—on no significant news. Alliant guided earnings below consensus, but that did not stop buyers; in another case of revaluation the stock rose in double digits. ONEOK took a more conventional path to leadership this quarter, beating earnings estimates by about 100% and increasing guidance. Like Integrys, Pepco rose on news that it would wind down its more aggressive retail supply business.

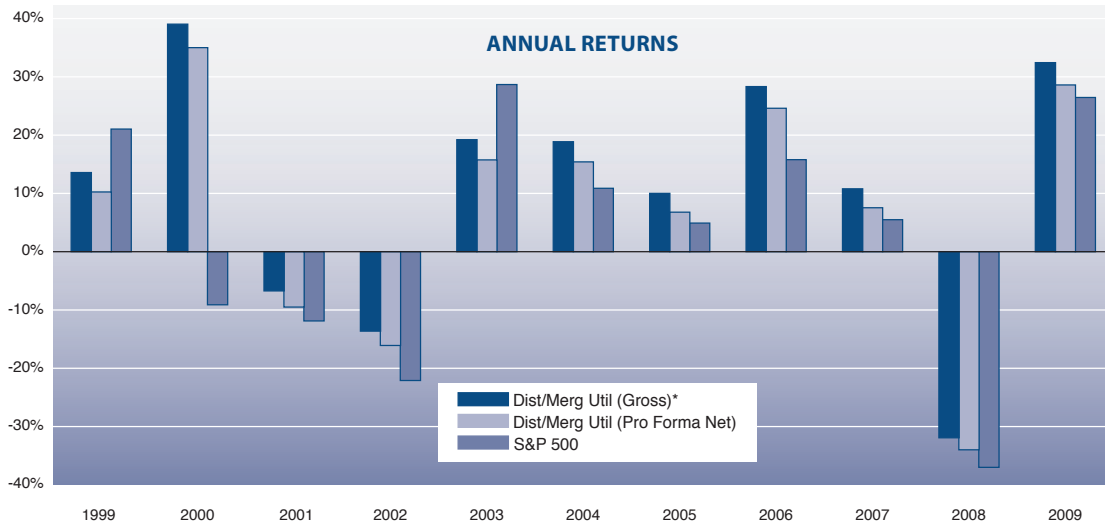
The few laggards included NRG, which has been so flippy as a consequence of deals and deal talk lately that we fear investors are simply bending to uncertainty. It doesn't help that electricity prices have been soft in response to a weakened economy and that their earnings substantially missed expectations. Rumor has it they intend to make yet another acquisition, in part to avoid vulnerability to a takeover. As a result, NRG is getting somewhat less attractive as a part of this strategy, and we're monitoring it more closely.

LOOKING AHEAD

A large crowd of our more conservative stocks posted impressive gains during the year and quarter, and we think they could use a bit of a rest. So we're a little more interested in buying on corrections here than on momentum opportunities.

But we really look ahead this quarter by looking back. This past quarter marked the eleventh year of the Distribution/Merging

continued on back page



*Gross returns are supplemental information to the pro forma net returns, which are not actual net returns but a simulation of the effects of 3% total annual fee, deducted monthly. MHI's highest annual fee as stated in our ADV is 1%.

In some charts and tables we show the S&P 500 index to give investors some measure of comparison to a broad market index. The above data is shown as supplemental information and complements the performance disclosure located on last page.

It was a mighty quarter and year for the pipeline and midstream energy sectors, and for our portfolio, which added value during a year in which differentiation was not an easy task. Indeed, with four consecutive double-digit quarterly performances, this was the best year ever for a sector/industry that has been leading the domestic market for a decade.

Our annual performance was helped by triple-digit gains in Williams Partners, Genesis Energy, Enterprise GP Holdings, and Regency Energy Partners, which illustrates how irrational the equity markets had become. After all, these are asset-based sources of cash flow, not internet concepts. But they had to gain that much to make up for the secular and unwarranted selling during 2008, even as business fundamentals continued to show reasonable health at the time. When your yearly laggards include large caps “only” up by plus or minus 30%, you know it’s been a very special year.

But it’s also been business as usual. Sixteen of the 20 holdings raised their distributions (dividends) at least once during the year, and there were a total of 36 distribution increases (a number of companies had multiple increases). Early 2009 capital market and economic uncertainty evolved into “old normalcy” for the MLP sector, which continued to produce solid financial results.

The fourth quarter in particular was a very active business period for our portfolio’s constituents. For example, Kinder Morgan raised \$286 million in equity, Linn \$181 million, NuStar \$289 million, and Regency \$200 million. Inergy raised \$400 million in equity and debt, and also renewed a \$525 million four-year revolving bank credit facility. The Fayetteville Express pipeline joint venture (JV) of Kinder Morgan and Energy Transfer secured a \$1.1 billion bank line. In total the MLP sector raised over \$16 billion in external capital in ’09 to reload their balance sheets. This in turn will finance internal growth projects or merger/acquisition—M&A that translates into incremental cash flow and increased distributions.

Fourth quarter accretive M&A activity was also vibrant. Linn paid \$154 million for Permian and Anadarko Basin oil/gas properties; Kinder Morgan paid Crosstex Energy LP

MLP STRATEGY

Current Yield[†]	7.3%	Proj Dividend Growth^{††}	6.0%
----------------------------------	------	--	------

[†]Weighted average.

^{††}Proj Dividend Growth is MHI Portfolio Team’s projection based on data from various sources adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

\$266 million for natural gas–treating assets; and Plains All American bought \$40 million in tankage assets from Holly. Notable JVs were ONEOK contracting with Targa Resources for a portion of Mont Belvieu fractionation capacity, and Kinder/Copano combining to develop natural gas gathering, transportation, and processing in the Eagle Ford area of south Texas. Denbury Resources Inc., the GP of Genesis, sold its GP interest to Quintana Capital, a private Houston-based energy investor. Also, Magellan Midstream Partners merged with its GP Magellan Midstream Holdings. All this activity will increase distributions in the years ahead.

There were two other very significant energy industry events in the fourth quarter, namely Exxon Mobil’s plan to acquire XTO Energy and Devon Energy’s restructuring announcement. Given the early-adopter reputations of Exxon’s and Devon’s managements, chances are good that other oil majors and independents will mimic the new North American–centric energy strategies. The important point for MLP investors: All new or expanded discoveries need new transportation infrastructure, and increasingly the producers have elected to remain out of this business. Organic growth prospects, in our view, are as good as they ever have been.

LOOKING FORWARD

Considering the spectacular portfolio performance in 2009, an experienced investor’s knee jerk reaction would be to think in terms of correction or profit taking. But 2009’s move was not a fad or mania; it was itself the upside corrective to 2008’s perfect storm of MLP price declines that had little to do with then-current business conditions or prospects. Indeed, MLPs still rate as undervalued compared to the measures that have been used in the past. These measures—spread to Treasuries, spread to Baa’s—are in our view of dubious merit due to the relatively short history of energy MLP trading and the fact that MLP investors enjoy an equity interest in entity growth (though distributions do compete with fixed-income payments, in theory). Still, having owned most of these assets, or similar assets, when they were in C-corp pipeline companies years ago, we believe we have a good idea of traditional price/EBITDA and price/book relationships, and we think valuation + distribution + estimated near-term growth, all add up to a group with continuing good appreciation prospects. Exiting allocators may induce air pockets from time to time, but we believe the impressive rebound of these companies will prompt potential sellers to think two or three times before letting them go again (and giving up those market-leading cash distributions!). [MHI](#)

MLP Strategy Composite Performance
GIPS composite disclosure shown in US dollars

Preliminary	Gross*	Pro Forma Net 3%	Pro Forma Net 1%	Alerian
Period to Date (3 mo’s to 12/31/09)	17.0%	16.2%	16.7%	16.6%
Since Inception (ending 12/31/09)	79.3%	74.3%	77.6%	76.4%

*Gross returns are supplemental information to the *pro forma* net returns, which are not *actual* net returns but a simulation of the effects of 3% total annual fee, deducted monthly. MHI’s highest annual fee as stated in our ADV is 1%.

The MLP Strategy Composite contains fully discretionary accounts invested in exchange-traded master limited partnerships that offer the potential for high tax-deferred income and growth of income. This is a customized version of the Master Limited Partnership Portfolio that was limited to only small-cap MLP companies. For comparison purposes this strategy is measured against the Alerian MLP Index, which is a composite of energy master limited partnerships calculated by Standard & Poor’s using a float-adjusted market capitalization methodology. See GIPS disclosure information on page 3.

PO Box 549
Woodstock, NY 12498
www.mhinvest.com

Client Services: Steve Chun
schun@mhinvest.com, (888) 282-8845

Internal Sales Desk: Mark Bolter
mark@mhinvest.com, (888) 282-8845

Central Region: Randall Cobb
randy@mhinvest.com, (614) 792-3644

Eastern Region: Keith Thompson
keith@mhinvest.com, (609) 953-7334

Western Region: Luke Theeuwes
luke@mhinvest.com, (951) 549-0913

Income-Equity Strategy continued from page 5

and sell-side strategists, the suitability of stock types for newly re-entering investors—that we can assert an arising bias in favor of our kinds of stocks without seeming or feeling self-serving. We also believe that the overall dividend picture across the market will improve this year: Banks repaying TARP will once again resume dividends. Companies that held back in fear of Armageddon will begin to loosen up again. What was night in 2008 and 2009 is likely to become day in 2010. Indeed, a race to the top in dividend increases wouldn't be a surprise. What was a little bit of a surprise was that in 2009, what some have

called the Year of the Cut (and certainly the worst since the Great Depression), we managed to have 23 dividend increases from 19 stocks this year, averaging 6% (distorted upward some by a 36% increase for CMS). At the end of the quarter the current dividend yield for our strategy that includes MLPs was 5.02% (including “regular special” dividends from Diamond Offshore). While projecting dividend increases at the portfolio level has become more difficult in terms of precise numbers, we do not have much trouble envisioning portfolio income growing faster than inflation in the periods ahead. **MH**

Distribution/Merging Utilities continued from page 10

strategy. It has been a period that saw the tech collapse, the jobless recovery thereafter, the junk rally of 2003, 9/11, war in Iraq and Afghanistan, and the near-annihilation of the financial system, followed by another junk rally.

The litany of the unpredictable was enough to throttle the S&P 500 back to negative returns for the period (seriously negative if you also adjust for inflation). But our steady eddy, unsexy category provided roughly 8.77% of alpha over the S&P 500, based on preliminary gross returns, with a volatility about 10% lower than the broad market and a beta in line with historical experience at .59. Interestingly, the portfolio outpaced the broad market not only for the total time period, but also outperformed in 9 out of 11 years, including last year's big rally.

We hope the upcoming decade is as good on an absolute and relative basis. Obviously the future holds unknowns, by definition, but it also holds knowns. The chief of these knowns is that we will all turn on the lights, heat our houses, and make phone calls. Distributors of these services will receive a reasonable allowed return on equity as local legal monopolies, something like a tax. That's the “bet” we make with this strategy, along with the bet that our stocks continue to be attractive acquisitions for larger companies seeking economies of scale. **MH**

Distribution/Merging Utilities Composite Performance			
GIPS composite disclosure shown in US dollars			
Preliminary	Gross*	Pro Forma Net	S&P Utilities
Period to Date (3 mo's to 12/31/09)	9.8%	9.0%	7.3%
1 Year per annum (ending 12/31/09)	32.4%	28.6%	11.9%
3 Years per annum (ending 12/31/09)	(0.1)%	(3.0)%	(1.7)%
5 Years per annum (ending 12/31/09)	7.1%	4.0%	6.0%
7 Years per annum (ending 12/31/09)	10.4%	7.2%	11.2%
10 Years per annum (ending 12/31/09)	8.4%	5.2%	4.9%

*Gross returns are supplemental information to the pro forma net returns, which are not actual net returns but a simulation of the effects of 3% total annual fee, deducted monthly. MHI's highest annual fee as stated in our ADV is 1%.

The Distribution/Merging Utilities strategy focus is to own broadly defined utility companies that we believe are likely takeover candidates. For comparison purposes this strategy is measured against the S&P Utility Index, which is an unmanaged, market-value-weighted total return index of all utility stocks in the S&P 500. We make no claims that our portfolio will track the index closely. In some charts and tables we show the S&P 500 index to give investors some measure of comparison to a broad market index. See GIPS disclosure information on page 3.