INVESTMENT PARTNERS ASSET MANAGEMENT
One Highland Avenue, Metuchen NJ 08840 Tel: 732-205-0391 Fax: 732-205-0395

**Excerpts from Quarterly Report Written by Investment Partners Asset Management Q2 2010**

**"MARKET REVIEW AND COMMENTARY**

…In our first quarter report, we commented on the likelihood that continued U.S. governmental intervention in the free markets at taxpayer expense would not clear the hidden liabilities that remain on the balance sheets of banks worldwide. Further evidence of that appeared in the second quarter when European central banks were called on to defend the Euro. The picture isn't pretty. Our belief is that unwinding of excessive debt worldwide remains far from complete in spite of what participants on "bubble TV" and in the print media would like to have you believe.

We also stated that we did not share Wall Street's conventional belief that the global economy had recovered sufficiently to justify the price level of equities, particularly in the developed world (U.S. and Europe).

As value and special situation investors, we suggested that our posture remain cautious. Our traditional hunting grounds produced some opportunities for profit during the quarter, particularly in the smaller and midsized companies, which have long been a sweet spot for us. The aftermath of failed governmental policies and over regulation left many companies without market sponsorship…

Because we still feel there is at least a reasonable chance that the economy will lapse into a second recession we expect to remain cautious and vigilant.

Deflationary forces if they take hold may produce outstanding opportunities. We believe we are well positioned to take advantage of these as they develop over the rest of the year.

**OUTLOOK AND STRATEGY – THE INFLATION DEFLATION DEBATE**

We believe that the aftermath of deleveraging initially, will unleash deflationary forces that are not easily overcome by monetary stimulus.

The Federal Reserve holds a different view i.e. that, more debt needs to be created, price stability can be targeted, interest rates can remain low and that deficits can be fought by changes in fiscal policy and Fed action. The markets have less and less confidence in orchestrated central bank initiatives and as a result economies in the developed world may not grow at above historic trend. We tend to listen to the markets rather than political pundits and muddled thinking optimists.

It is times like now that turn skeptics into cynics. For the time being we believe we will see a period where investor disillusionment overtakes hope. We have decided to continue our "go-slow" approach because the economic environment lacks clarity…

In the coming months we believe that our strategy to focus on companies with strong balance sheets, above-average discretionary cash flows, and an ability to pay dividends in a yield starved world will provide the impetus to attract capital as investors gradually gravitate from the supposed safety of low interest Government bonds toward quality equities….

Essentially, there are three central themes:

1. Investments in individual companies, closed-end funds, and ETFs that represent holdings in infrastructure and energy assets that are selling at discounts to their intrinsic values and distribute cash periodically.

2. Investments in companies with abundant cash flows and significant balance sheet assets particularly those engaged in technology.

3. Investments in companies in health care and services that we believe sell at distressed prices.

In the months ahead we intend to build on these themes in the belief that certain international businesses will be beneficiaries in either a deflation or inflationary environment. We also expect to devote more attention to natural resource assets and manufacturing rather than services…

Finally, in the years ahead you should know that we are excited by believing our quest to identify promising companies that sell at discounts to their expected long term value should result in the construction of a unique actively managed portfolio.

We are not content with just holding issues and hoping that the market will one day recognize them for what they are. Many of our investments may require recognition that shareholders have a voice - applause for a job well done and criticism when called for… Constructive suggestions on how to benefit shareholders and the company itself are, surprisingly, often well received. We believe that our advocacy and activist stance will as time goes on will contribute to our overall performance. We look forward to demonstrating how we redefine value investing in the months ahead…

**ADDITIONAL COMMENTARY**

If the bombing of the World Trade towers were a precursor to the collapse of world markets throughout the 2000's, Katrina and the BP Macando oil gusher of 2010 represents a feeling of frustration and helplessness. When all Hell breaks loose, little can be done to forestall the inevitable. In the case of BP a high pressure crack in the mantle of the earth has unleashed forces not readily containable. It is too bad the world's central banks don't recognize how flawed the world's financial system is with its reliance on paper money and runway debt creation to solve the problem of too much debt. Whether it is sovereign debts, war drums, political unrest or the battle of the Rising East versus the established West, the fabled market's "Wall of Worry" maybe too high to climb this time.

So, just as BP has capped the gusher (for now), so too have the monetary authorities thwarted deflationary forces (temporarily?) through the use of their own weapon – the printing press. Up to this point, the printing press has been the weapon of choice. Whenever the market sees and dislikes a flaw in the global banking system, the printing press is summoned and the problem is solved (for a day or two) then, a new problem arises, as money seeps through a different hole in the system. The fire is momentarily contained, but never really out.

The markets have grown weary with all this. Our leaders seem incompetent and self serving. For all practical purposes every day is a new day where crisis management prevails. Had we written this piece last week, we would have had one opinion. This week we have another. What changes our minds? The market is sensing (this week), that the more deflationary signals the authorities receive (all the time), the more likely they are to throw A LOT more money at the problems and hope they go away (for a month or two). The market has risen (for now) because people sense that they may have to legitimize their dollars (fast), before they become massively diluted (again). Never mind the source of the funds or use of proceeds – these things are seemingly irrelevant to both the borrower and lender. Normally creditors wish to know how and when they are going to be repaid. When dealing with government borrowers, there is no repayment just a rolling over of the debt.

Without the trust in the integrity of the borrower, the creditor may ultimately withdraw from the market or demand greater protection in the form of interest… or, God forbid, collateral. The medium of exchange reflects the degree of confidence. The last meltdown was defined, at least according to the powers that be, by the crisis that everyone claims that they did not see coming, and hence were wholly unprepared.

This time is different. It is inevitable that accelerated debt creation may bring down the House of Cards. Mathematically, it is easy to see it coming. It is just a question of when. The extension of credit to those who could never pay it back was obviously a catalyst for a market downturn, but the deleveraging effects were both less apparent and geometrically more malignant. But, as history has proven (for now), the subprime credit crisis was nothing that $787bn (or whatever) couldn't fix. Buildings fall, and are then rebuilt. Wells leak and then are capped. To oversimplify, the process of getting us to the next day in 2009 was rocky, but was child's play, compared to what could befall us as a nation in the future. The US, Europe and Japan have all become subprime borrowers, and each just keeps on borrowing, at an accelerating pace, with less GDP growth. This pray and delay tactic has solely one purpose to get the orchestrators one step closer to tomorrow.

As the subprime crisis was a catalyst for "it" coming, it follows that we can see "it" coming again in a manner similarly chaotic to the oil gusher metaphor. Everyone can. Except that everyone cannot agree on the form "it" will assume, runaway inflation or asset-based deflation (or both). It's positively bipolar, and is providing unprecedented challenges to investors with a long term focus.

Imagine this schizophrenia - While Europeans and Asians riot to continue the profligate ways of the past, Americans are seeking austerity measures (until, of course, the "austerity" measures hit the ones clamoring for it). While we see more US dollars and Euros ever printed in the history of humanity, we see asset price deflation, record low monetary velocity, unwavering unemployment, an incredibly low 10 year yield (2.88%), oil over $80/barrel, and the Yen carry trade being dismantled at an alarming rate. While we hear the war hawks preparing us for the take down of the "axis of evil," we are witnessing increasingly more global scarcity for the staples and their means of transport. While the pundits all claim that higher taxes are around the corner, the government remains incredibly deficient in collections. We certainly have uncertainty (as Ben Bernanke admits), the type of which has been historically anathema to advancing markets.

If markets are in fact as efficient as many claim, then more than a few stand to be spectacularly wrong in the coming months about direction and timing. Efficient markets, in theory have stable prices. However, when one set of premonitions is proven incorrect, the opportunity for those who get it right can be astounding. We have seen these types of situations arise before, have guided you through them, and have made you better off coming out than going in. We hope to again be on the side of the angels, and this could occur if we remain carefully mindful to two major trends regarding <u>sustainability and evidence.</u>

On the sustainability front, we have intellectual difficulty in assuming what we have been conditioned to believe over the decades; that global monetary authorities can coordinate efforts to add more zeros to the system and maintain a semblance of meaningful price stability (i.e., without unleashing tremendous inflation). The day-to-day crisis management style has brought us this far, why question it?

For example, if the US national debt is 13 trillion now, why can it not be 14, 18, or 25 trillion? If the PIIGS nations of Europe owe and cannot repay 5 trillion Euros to creditors, why can't this morph into a 10 trillion problem? If the shadow derivatives market stands at 600 trillion, what is impeding its march to a quadrillion or more? This approach to policy has served to kick the can down the road since the dawn of the separation from hard money in 1971. What makes 2010-2011 any different? This is the paradigm of sustainability in a nutshell, and it is anyone's guess as to how much longer creditors will find this approach meaningful, relevant, effective, benign, or financeable at record low rates. Ponder this; the level of economic activity and market earnings we are seeing now are directly proportionate to the geometrical expansion of deficits and debt we are able to incur. This is the reason why we own fewer securities this time than in the past.

What would the world look like if former sustainability were no longer sustainable? Understanding this point is exactly where the evidence comes in. To list the bricks in the wall of worry in this column would probably exceed its useful length. Let us just say it is extensive, complete, worldwide, and persistent (not day to day). They encompass everything from exchange rates to demography. The diversity of concerns that seem to be spewing from the underworld is providing market geologists an equally daunting task of capping the flow as those which have heretofore faced BP. In the past, more money has served as a type of blow out preventer. However, like the oil gusher, the building deflationary pressures from other cracks in the monetary seafloor are beginning to seep through daily, as the mounting evidence suggests.

The only thing that we as managers can do in this situation is to invest in securities which own their assets outright and do not act primarily as managers on behalf of their creditors. Why? Because as more money is thrown at systemic problems, the shortage of bankable collateral compounds. As such, we are seeking well-capitalized businesses that sustainably distribute cash, or have such an impressive cash hoard so that the enterprise can withstand turbulence going forward..."

## DISCLAIMER

Any information and/or recommendation contained in this report should not be considered a complete analysis of every material fact with respect to any company, industry, or security. Any and all investments discussed herein may not be suitable for all investors, and may be subject to a high degree of risk. For this and other reasons, Investment Partners Asset Management ("IPAM") does not recommend that investors buy or sell any of the securities mentioned in this report. Furthermore, there is no certainty, and we make no guarantee, that any recommendation or strategy discussed in this report may be executable in an appropriate size or amount and/or at the prices described herein. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed. Investment Partners Group and/or its affiliates (including but not limited to IPAM) may effect transactions, including transactions contrary to any recommendations herein for themselves or their clients (including but not limited to investment vehicles managed by IPAM, and/or their affiliates).

Furthermore, Investment Partners Group and/or its affiliates (including but not limited to IPAM) may have positions in the securities mentioned herein, (or options with respect thereto) and may also have performed investment banking services for the issuers of such securities. In addition, employees of Investment Partners Group and/or its affiliates (including but not limited to IPAM) their families and other affiliated persons, may have positions and effect transactions, including transactions contrary to any recommendations herein, in the securities or options of the issuers mentioned herein and may serve as directors of such issuers.

## FORWARD LOOKING STATEMENTS

This discussion and analysis contains certain forward-looking statements and projections that involve a number of risks and uncertainties. Actual events or results may differ materially from the expectations and projections. Past performance does not guarantee future results. Market and other risks may affect the actual results achieved by accounts or investment vehicles managed by IPAM and/or its affiliates.