

W. H. REAVES & COMPANY

INVESTMENT MANAGEMENT

SPECIALIZING IN EQUITY INVESTMENTS SINCE 1961

Fourth Quarter 2007

Review and Outlook

Solid Performance Despite Turbulent Markets

Barron's: "Art (Samberg) what do you think"?

Art: "The economy stinks."

Source: Barron's Roundtable January 14, 2008

We are pleased with the exceptionally strong performance of our portfolios in 2007¹.

The volatility experienced in the third quarter continued in the fourth quarter in response to the liquidity problems resulting from the ongoing the sub-prime mortgage crisis. Overall, the portfolios realized positive returns for the quarter – up in October, down in November and up modestly in December. The unfolding of the sub-prime crisis and speculation about its likely impact on the US and world economies, coupled with global political instability, created investor uncertainty.

Quantitative funds, which trade using statistical models, partially account for the much higher trading volumes and sudden price movements observed in U.S. equity indexes. For example, the Tabb Group, a U.S. consultancy, predicts that by 2010 algorithmic trading will account for half of all U.S. equity trading. Since August, when many of these quant funds experienced significant losses, the developers of these models have been trying to “fix” them. The way we see it, volatility begets even more volatility and presents opportunities to us. Within our investment universe we will seek to reposition the portfolio to benefit from distortions arising in the market.

¹ Reaves performance data is the W. H. Reaves & Co., Inc. ERISA Composite. The WHR ERISA Composite reflects the dollar-weighted return of all corporate ERISA pension accounts with assets of at least \$1 million under management for all periods presented. Returns are time-weighted and include the reinvestment of all dividends and other earnings, net of commissions. The ERISA Composite does not reflect all of the firm's assets under management.

Our portfolios, which focus on major sectors of the energy and communications infrastructure, are deemed to be defensive by many investors. We believe the stocks' defensive character stems from their above average dividend yield, relatively predictable earnings, below market price earnings ratios and the essentially non-discretionary nature of the products and services provided. Because of their defensive characteristics, our portfolio holdings tend to be less risky (i.e. less volatile) than the overall market. On the commonly accepted Value at Risk measure (VAR)², our current consolidated portfolio scored 1.39% vs. 1.80% for the S&P 500.

Electric utilities performed well in the quarter, mainly driven by the merchant generators and the transmission companies. We have noted several times in this space that electric power supplies remain tight in some markets, and the transmission grid is in dire need of significant investment to improve reliability and distribution capabilities. These conditions provide growth opportunities for selected utilities operating in states with favorable regulatory environments.

The portfolio's natural gas related utilities, with the exception of one security, all had positive returns. The September 30, 2007 price of natural gas at Henry Hub was \$6.15 per mcf and closed on December 31, 2007 at \$7.45 per mcf, just below the quarter's high price of \$7.53 per mcf. This price increase has enhanced some portfolio securities due to their exposure to natural gas exploration and productions assets.

² This is for a one-day return horizon at the 95% level of confidence.

The 21% increase in the price of West Texas Intermediate (WTI) oil from \$81.66 to the November 20th peak of \$98.88 provided some trading opportunities in the integrated oil stocks. Transocean completed the Global SantaFe acquisition, which included a meaningful special dividend.

Telephone was the only portfolio sector to generate negative returns in the quarter. Rural telecom was the primary source of weakness, largely on concerns over sub-prime issues affecting customers in specific Florida, Nevada, and California markets, and more generally on the ability of these carriers to grow. These relatively high yielding stocks may have been affected by the unwinding of the “carry trade” due to appreciation of the Japanese yen in the quarter. We think high-speed data affords some companies organic growth opportunities. Our expectation is for generally stable prices. In addition, some companies in this space have the potential to grow via small acquisitions.

As the debate rages around us as to whether the economy is or is not in a recession, or whether this is just a mid cycle slow down, we remain constructive on the earnings and dividend growth outlook for your investments. Over the longer term regulatory support for essential investment in transmission, distribution, pipe lines and other energy infrastructure should be sustained. As a consequence of this new investment earnings are expected to increase. Power prices remain firm and supply is short or constrained by inadequate infrastructure in some areas of the country.

Eventually, we expect some form of carbon legislation in the United States, probably after 2008. Carbon legislation should favor natural gas as the cleanest of the carbon fuels and utilities with significant nuclear generating capacity. While we expect natural gas to remain the environmentally friendly fuel of choice, proven reserves are depleting. Some analysts looked to liquefied natural gas (LNG) to satisfy part of the increased US demand. However, it appears now that the potential arrival of material LNG imports is some years away. There is also the risk that the needed volumes may not reach the U.S. market because higher prices in foreign markets may result in LNG cargoes being “bid away”. Conceivably, natural gas prices could continue to rise despite a weak U.S. economy.

While we continue to believe that high prices for oil contribute to demand destruction, global consumption will continue to grow, and the need to

replace reserves will necessitate ever greater industry investment: recession or no recession. The oil service companies in our portfolio will be the beneficiaries of this trend. Additionally, some of the integrated oils continue to increase dividends, buy back stock and add to proven oil and gas reserves. We continue to maintain these companies in our portfolio.

Our portfolio investments have been chosen with the expectation that they are capable of growing earnings and supplementing returns by paying dividends at above-market levels. The majority of the equity holdings are, in our opinion, capable of periodic dividend increases.

We thank you for your support and appreciate your continued confidence.

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