

Greatmark Investment Partners

October 2010

Partner's Letter

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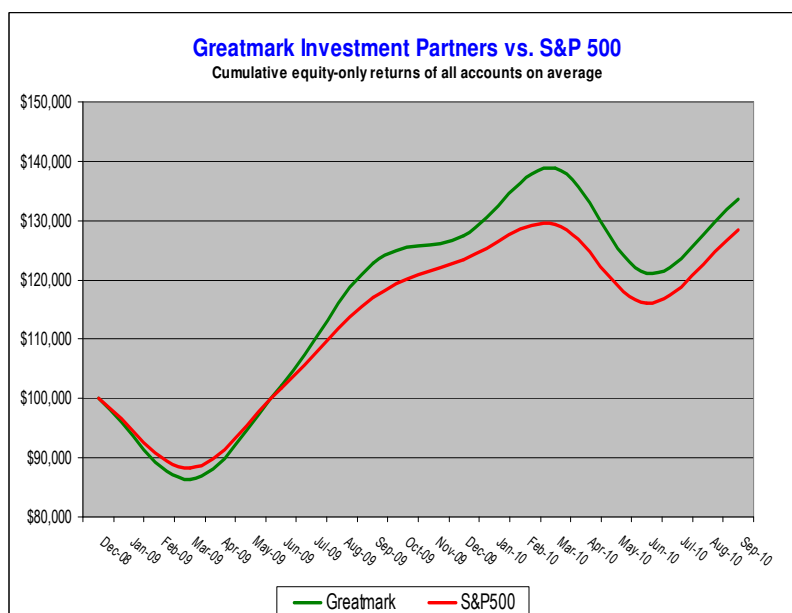
Past performance is no guarantee of future results. All investments involve risk, including possible loss of principal. Investments in equity securities are subject to price fluctuation and possible loss of principal.

The mention of any individual securities should neither constitute nor be construed as a recommendation to purchase or sell securities, and the information provided regarding such individual securities is not a sufficient basis upon which to make any investment decision. Any statistics have been obtained from sources the portfolio managers believe to be reliable, but the accuracy and completeness of the information cannot be guaranteed.

A very good third quarter – all eyes on the next 90 days

We had the best September in the market since 1939. Who would've thought that was possible given the current tone in the country? Despite the negative news and sentiment, stocks did indeed snap back in September and that fueled a strong 10.7% advance for the S&P 500 for the third quarter. Our equities (*pooling all our accounts together as one account*) gained 10.4% for the quarter. For the year, we are up 4.0% while the S&P is up 2.3%. Since the end of 2008, our equities are up 31.8% while the S&P is up 26.3%...

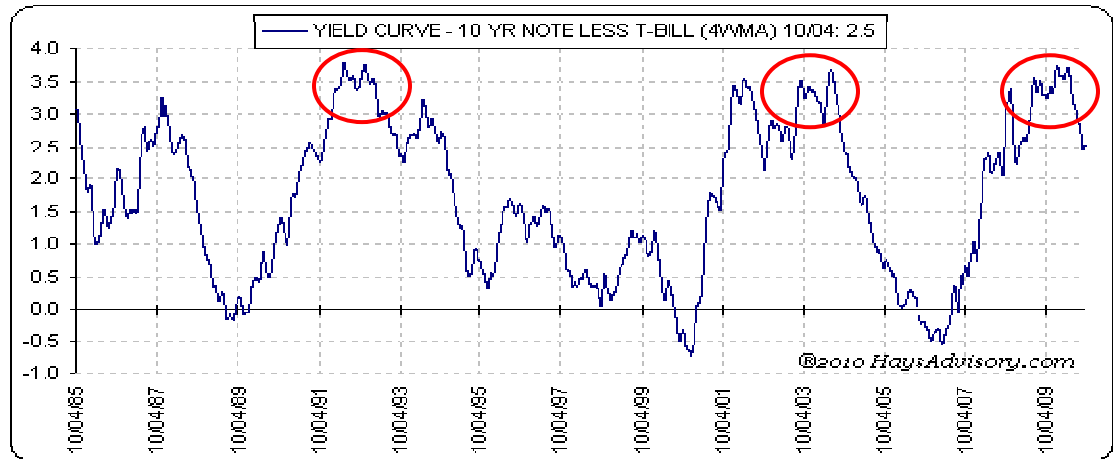
	Greatmark (equity)	S&P 500
1Q 2009	- 13.6%	- 11.7%
2Q 2009	+ 18.2%	+ 15.2%
3Q 2009	+ 20.3%	+ 15.0%
4Q 2009	+ 3.7%	+ 5.5%
1Q 2010	+ 9.0%	+ 4.9%
2Q 2010	- 12.8%	- 10.4%
3Q 2010	+ 10.4%	+ 10.7%



Investing is a marathon, not a sprint. We don't obsess over one quarter's worth of results or even the results over 18 months. True success as an investor comes over a long period of time. Too much focus on the short-term or why 1-2 stocks "aren't working" or deciding to jump onto a faster moving train can lead an investor to make an expensive mistake. We very much believe that "Slow and steady wins the race".

We think the next 18 months can be very good ones for the stock market and in this letter we will tell you why.

1. **Stocks are cheap.** The S&P 500 today trades for 13.7x this year's earnings compared to a 40-year average of 16.6x current year earnings. The market trades for just 12x next year's earnings compared to the long-term average of 15x earnings. The market is trading about 20% cheaper than its long-term average. Many of our holdings have increased their dividends this year and many are buying back their cheap shares. The strongest argument we have for our optimism is grounded in the fact that many great companies are really cheap.
2. **Interest rates are at historic lows.** Stocks should always be compared to returns offered from other investment choices, i.e. bonds, CD's, money markets, real estate, etc. As we have discussed many times with you, a record amount of money is flooding into bonds and bond funds. Since January of last year investors have put more than \$600 billion into bond funds while they've withdrawn \$35 billion from stock funds. This flood of money has helped drive interest rates to historic lows and bond prices have soared. The 10 year government bond, which has averaged a yield of 4.30% over the past 10 years, now yields just 2.40%. Historically, low interest rates are very bullish for stocks.
3. **Cash.** Cash levels remain elevated all across America. More than \$3 trillion still sits in low-yielding bank accounts and money markets. Some of that money is going into bond funds because investors think they are getting better yields with no risk. That is a foolish assumption. But the rest of the money surely cannot be content for long to earn **almost nothing** on those deposits. We think a good bit of that money will go into dividend paying stocks. Corporate America has more cash on its collective balance sheet now than at any time in recent history. Corporations bunkered down during the worst of the crisis and are only just now starting to invest that cash hoard. Cash is being deployed on increasing dividends, buying back stock and making strategic acquisitions of competitors. By removing the cash from "sitting" status and getting it invested or returned to investors, a huge shot of capital is being injected into the economy.
4. **The economy is improving.** Albeit at a gradual and choppy pace, the economy is improving. Industrial production is expanding. Factory orders are growing. The service side of the economy is expanding. The weekly jobless claim data is gradually improving. This recovery is not nearly as strong as we want or frankly as we expected. We believe corporations are holding back some because of the uncertainty in Washington over taxes and healthcare. In May it seemed we might be heading back into a double-dip recession and the market pulled back sharply over those fears. But the data started to improve again in August/September and the consensus is that a double-dip is off the table for now.
5. **Cycles feed on themselves.** We certainly lived through a negative cycle in 2008 and early 2009. But now the cycle has turned and is starting to feed on itself. The data is improving. Corporations are no longer hoarding cash but are using it to buy back stock, expand and buy other companies. That cash fuels other purchases. Cash influxes lead to more spending. More spending = more demand = the need for more production = an increase in factory orders. This fuels a rising stock market. Clients see the improvement in their portfolios vs. last year, they see their 401(k)'s growing and they start to feel a bit more confident. Consumer confidence = more consumer purchases = the cycle feeding on itself.
6. **The yield curve.** The yield curve which measures the difference between short-term interest rates and longer-term interest rates is very steep (*short rates are almost 0% vs. the 10-year bond rate of 2.4%*). A steep yield curve almost always signals a time of strong economic expansion coming while an inverted yield curve (*when short term rates are higher than long-term rates*) almost always signals an impending recession. We have a very steep curve today and it has been this steep only three times in the past 30 years. The last two times, 1992 and 2003, a roaring economic expansion **and** bull market followed...



7. **Political seasons.** Historically the third year of a President's term is the best year for stocks. What is fascinating is that this trend actually starts in November of his second year and lasts through April of his third year. The market has averaged a 16% return in the November-April time of a President's third year.
8. **Still very few believe any of this.** Despite the better news, the improving economic data, the incredibly low interest rates and despite a stock market that is 30% higher than it was last summer...very few people believe things are getting better. We think that is directly tied to fear over what will come next from Washington, an aging investor base (*the bulk of the stock market wealth is held by investors 60-70+ years old*) worried about retirement and the still high unemployment rate. Many people are convinced that *"this time is different"* and that America's best days are behind it. We would argue this consensus is common at the end of every recession – it certainly was present in the late-70's with double digit interest rates and inflation. It certainly was present in 2001-2002 after 9/11 and the dot-com bust. Our tendency is to think the current problems cannot be fixed...but America always seems to find a way forward. We don't think this time will be any different. Sir John Templeton very wisely said in 1949, ***"Now that the bear market has lasted three years, it is well to remember both bear markets and business depressions are temporary. People do not remain pessimistic forever."*** As long as the consensus is negative, that is bullish for stocks. Bull markets climb walls of worry and as long as pessimism is ruling the day – which it does today – we will remain bullish. When the whole world "jumps on the train" and stocks are again in vogue, we'll start being cautious.

We are very optimistic about the next 18 months. The fears we share – *what will transpire in Washington, what tax rates will do, what healthcare will truly cost, what we'll do about our national debt, global economic uncertainty, the persistent fears of terrorism* – are real. There is a great deal of uncertainty in corporate America surrounding these issues. Unemployment remains stubbornly high as businesses are reluctant to add new workers in a legislative environment that might be less than business-friendly. We think we will have a lot of clarity on some of these issues over the next 90 days. The mid-term Congressional elections could usher in a Republican House and, therefore, some checks and balances that don't exist today. We strongly believe that raising taxes for any taxpayer could be disastrous for our economy at this juncture so soon after a severe recession. Washington has two choices – raise our taxes or control their spending. Overwhelmingly the country seems to be shifting toward holding Washington accountable for their actions. This shift could be very bullish for all of us. We believe that the best way to raise revenues for the Federal budget is by energizing our economy. A strong and growing GDP will produce strong tax revenues. We

see signs that this growth is coming but we warn that a big tax hike at the precise wrong time could derail this recovery. All eyes should be on Washington for the next 90 days.

Bottom line – we focus on the fundamentals of investing

With a lot of uncertainty, we **are** certain in businesses we own. They are producing huge cash flows, raising their dividends, have fortress balance sheets, are buying back a ton of their own stock and are expanding by buying weaker competitors. We can't know when their stock prices will reach our desired goal but we do know they are doing exactly the right thing. **Time becomes your asset when you own great businesses.** Consider this summary of twenty of our top holdings – J&J, Intel, GE, Emerson, UPS, Nokia, Microsoft, Home Depot, Coke, Conoco, etc. – 17 of the 20 are A++ and 1 rated by Value Line, they are expected to grow earnings 36% this year and 11% next. They have a combined 3.1% dividend yield and have increased their dividend at an average of 14% a year over the past decade. Their return on equity has averaged 24% a year and they have bought back 10% of their shares since 2002. Statistically and by reputation, these are among the “best of the best”. You would think they would be too pricey to buy. They should be, but they aren't. This group trades for just 12x next year's earnings and will pay you 3.1% a year in dividends while you wait for them to compound wealth for you. As we look at the improving environment and the excellent companies we own, we are quite optimistic. Thank you for your partnership. We look forward to even better days ahead.

Greatmark Investment Partners, Inc.

Jeff Adams & Richard Illges