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Discussion Topics

Master Limited Partnerships

The Dollar / Foreign Markets

Commodities

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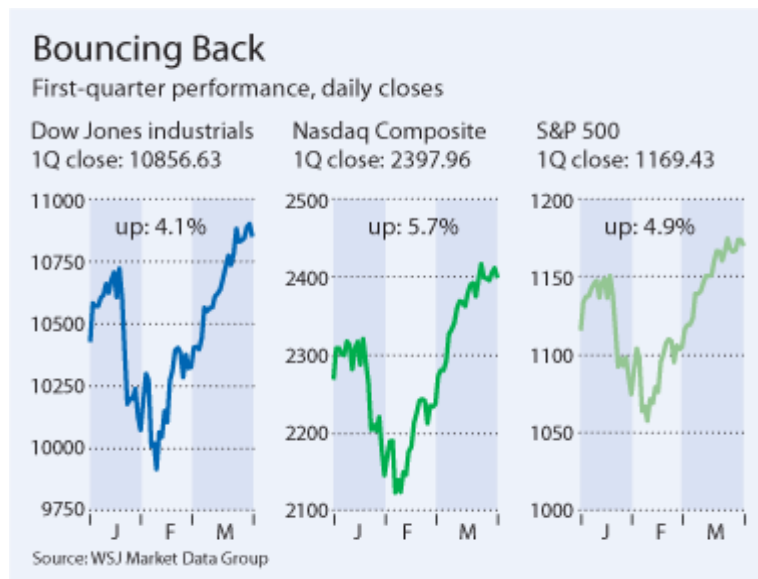
Dear Client;

The economic trends that provided the impetus for the sharp equity market recovery in 2009 continued during the first quarter of 2010 and the indexes responded favorably. Corporate earnings again came in stronger than expected and the battered U.S. economy continued its convalescence.

The Dow Jones Industrial Average gained 4.1% or 428.58 points during the first quarter, to 10856.63. That marked the Dow's fourth consecutive quarterly gain and the best first-quarter performance since 1999. The broad Standard & Poor's 500-stock index rose 4.9% to 1169.43, but remains 25% below its all-time high posted in October 2007.

The quarter provided substantial volatility; there was a sharp sell off in February followed by a dynamic rally in March as central bankers continued to work their way through the aftermath of the 2008 crisis. Markets responded sharply as China began to reverse its economic stimulus program, the Greek debt crisis intensified and an unsettled political climate in the US dominated headlines.

A flood of cash into fixed income—coupled with the knock-on effect of the Federal Reserve's mortgage-backed securities buying spree—helped lift returns on investment-grade and high-yield bonds.



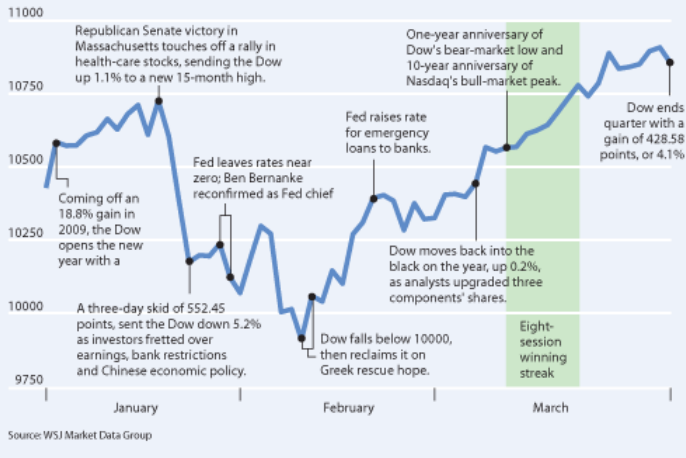
As the Fed moves closer to ending and ultimately reversing the current unprecedented easing of credit, the markets will be watching carefully. On the positive side of the current situation ledger is the fact that US corporate balance sheets are in solid shape and valuations are reasonable on a historical basis.

As has been the case since stocks hit their lows in March 2009, the best-performing stocks have tended to be the most volatile and generally lower-quality names. The Russell 2000 index of small-company stocks posted the largest gain among the big benchmarks with an 8.5% rise. Financial stocks, too, rallied despite the likelihood of stepped-up regulation and lower future profits. The Financial Select SPDR gained nearly 11%.

The gains experienced during the first quarter were certainly more muted than the “moon shot” rally off the lows in March 2009. Earnings were strong as expected but investor concerns over the potential for the Greek situation to spread to the other core economies in Europe as well as the health-care debate in Washington drew substantial attention. By February 9 the Dow had retreated more than 7% from a mid-

Dow Rewind | The industrials' first-quarter performance

The Dow Jones Industrial Average in the January-February-March quarter



January high. As it became clearer that the debt crisis would be “handled” stocks pushed higher for the balance of the first quarter.

Although many observers had been concerned about the possibility of a “double dip” as the year started, there is a growing conviction that the US economy is generally on the road to recovery, although with weak areas such as housing. As the economy improves there is a growing likelihood for higher interest rates. Investors are also watching interest rate rises in developing markets; India raised rates last month and Brazil is expected to tighten soon. In China, where demand for raw materials has been driving commodities prices and the outlook for energy and materials stocks, expectations are generally that China will adopt a “go-slow” approach to rising interest rates.

Corporate balance sheets continue to provide a measure of

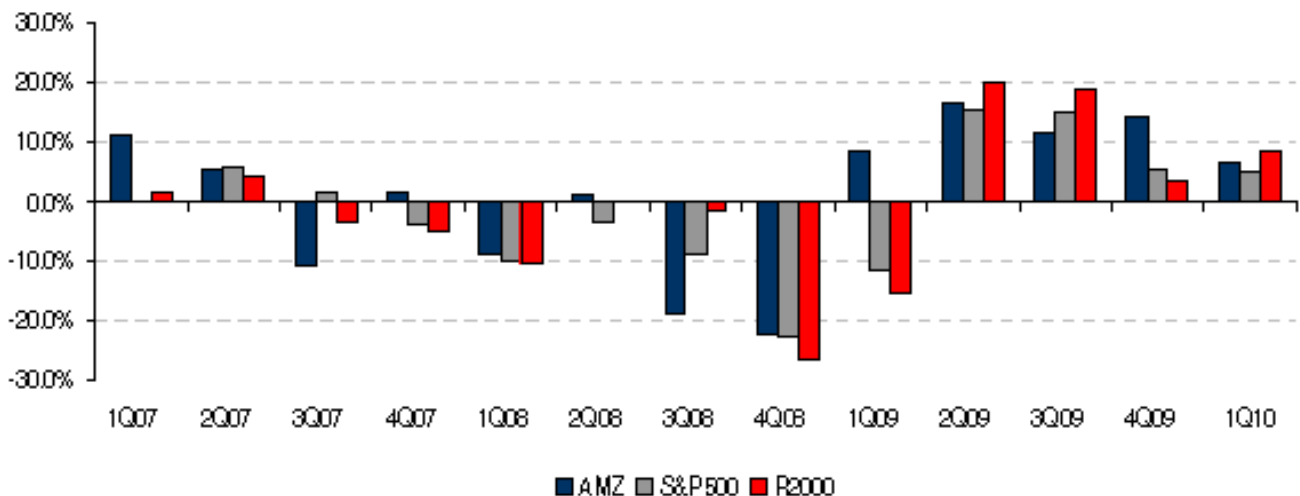
underlying support. During the fourth quarter of 2009, undistributed corporate profits reached an all-time high of \$527 billion after a steep decline during the financial crisis. Nonfinancial companies in the S&P 500 have a record \$830 billion of cash on their books. In recent weeks there have been a number of dividend hikes which is a positive for equities.

Master Limited Partnerships

Master Limited Partnerships experienced a strong first quarter, posting price appreciation of 6.4% based on the Alerian MLP Index versus gains of 4.9% for the S&P 500. The average yield now stands at 6.9% and, for the first time this year, the MLP yield relative to the 10 year treasury has fallen below its average spread. The current spread is 309 basis points versus the average spread of 320 basis points. This suggests that MLPs, on average, are fairly valued, but not overvalued. We continue to believe that MLPs can move higher and that the Alerian Index (AMZ) may surpass its all-time high of 342 reached in July of 2007. A move to this point would be equivalent to a total return potential of about 18.5% for 2010.

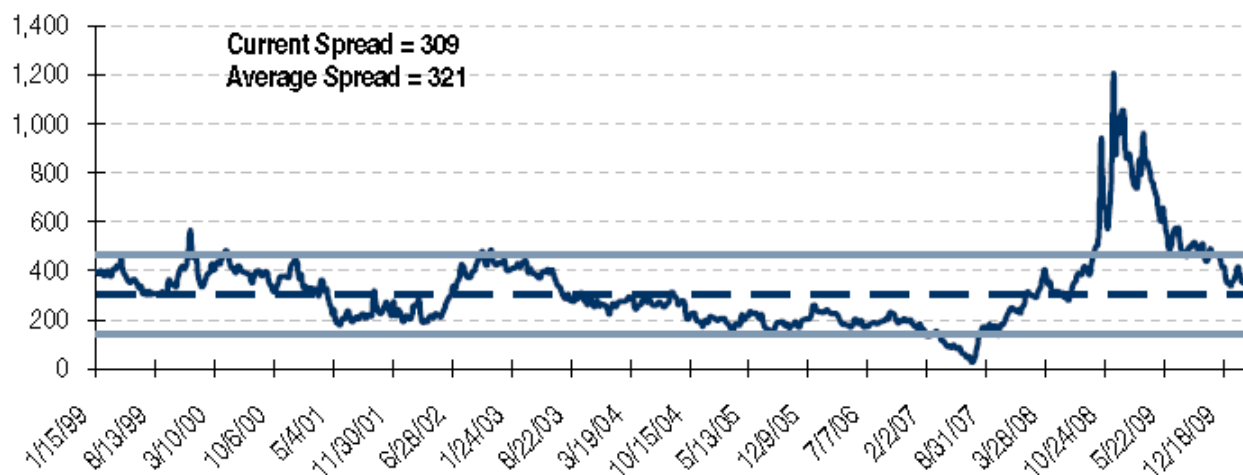
At their peak, MLPs traded at a yield of 5.4% which was just 26 basis points above the 10 year treasury. Due to the fact that yields have grown almost 16% since then, the equivalent yield today at the peak price of 342 would equate to 6.2% and a 230 basis point premium to the 10 year treasury. What they continued improvement in the economic outlook and positive investor sentiment this may be a viable outcome.

Although the yield spread between MLPs and the 10 year treasury will narrow if interest rates gradually rise, the value proposition of an approximate 7% yield plus distribution growth of 3% to 5% is attractive whether the 10 year treasury yield is 4% or 5%.



Source: FactSet, Bloomberg

AMZ MLP Index Spread to 10-Yr Treasury



During March MLPs underperformed the S&P 500's gain of 5.9%, attributable partially to weak natural gas prices and a heavy equity issuance calendar. These factors were offset partially by solid earnings results and the continued attractiveness of MLP yields versus alternative investments.

The recent health-care legislation includes a provision that provides for a 3.8% tax on interest, dividends, annuities, royalties, capital gains, and rental income for individuals and families earning more than \$200,000 and \$250,000, respectively by 2013. While the annual income allocated (not tax-deferred) to an investor or, capital gains, and depreciation recapture would be subject to this provision, cash distributions are not. As a result, MLPs become relatively more attractive given the effective increase in tax rates for other income - oriented securities.

The Federal Energy Regulatory Commission (FERC) continues to support pipeline development. FERC Commissioners testified before a House Subcommittee reaffirming the agency's view that a diversified pipeline system was vital to our national interests. The FERC estimates that North America will need between 28,900 and 61,900 miles of new natural gas pipelines by 2030, requiring an investment of \$108-\$163 billion to accommodate changes in natural gas supply and demand. These factors highlight the still meaningful growth potential for the industry.

The Dollar / Foreign Markets

The dollar staged a substantial rally during the first quarter of 2010, reversing a trend that existed for most of 2009. Much of the greenbacks improved tone came at the expense of the Euro as European governments considered a solution to the Greek debt crisis. The Euro also was pressured by concern that Spain and Portugal could also slide into crisis. In all, the Euro decline 11% from its peak last November. In the wake of the EU plans, many observers suggest that a target of \$1.20 for the Euro (down from more than \$1.60 last year) is very possible.

The Japanese Yen has remained resilient despite a troubled Japanese economy. Repatriation of investment income by Japanese investors is a likely reason for the currency's buoyancy. But as the quarter wound down, the yen weakened as the Bank of Japan took additional steps to pump money into the country's financial system.

Against emerging-market and commodity-producing countries, the dollar also struggled in the first quarter. The Brazilian real fell 2%, and the Canadian dollar gained 3.51% as it approached parity with the U.S. for the second time since 1976.

Much of what happens in the big commodity-producing countries and broadly in the foreign-exchange arena will depend on a currency-market wildcard: China, whose currency has been effectively pegged to the dollar since Beijing halted the gradual appreciation of the yuan in mid-2008.

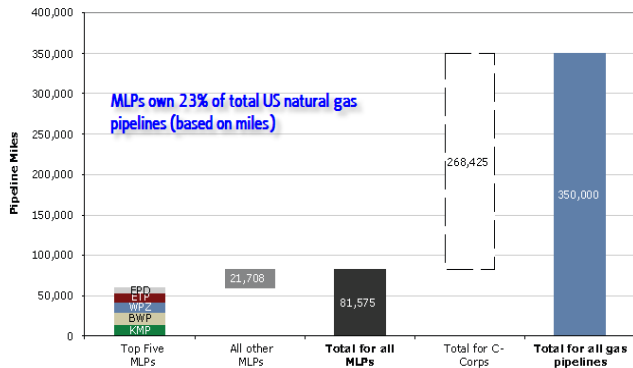
China is widely forecast to start raising interest rates in coming months to cool its fast-growing economy. That could hurt demand for raw materials and weaken so-called commodity currencies like those of Australia and Canada. China also is being pressured by U.S. officials to allow the yuan to appreciate against the dollar, which some think could happen by year's end despite diplomatic wrangling. That in turn would make its exports more expensive abroad and possibly lend a prop to the dollar and rival Asian currencies. For the most part, the expectation is that China will trim economic growth but not stamp on the brakes.

Although in the US the Federal Reserve indicates that interest rates are likely to stay at low levels for an "extended period", the central bank is allowing some of the extraordinary measures it took to fight the economic downturn—such as its \$1.25 trillion mortgage asset buying program—to be phased out as planned. With the global recession fading into the background, some nations such as India and Australia have started tightening monetary policy. In China, worries about overheated home prices

prompted the government to tamp down on mortgage lending and land sales.

Concern over what happens as stimulus is removed from the system (the “punchbowl gets taken away” scenario) is evidenced strongly in China. During the first quarter, the Shanghai

Japan’s Nikkei Index was relatively strong during the first quarter, gaining 5.2% versus a 4.1% rise for the DJ Asia Pacific Index. As the global economies heal, the type of capital goods and technology products that Japan’s economy is geared to produce could drive Japanese corporate earnings.



Composite Index and Hong Kong’s Hang Seng Index, on which many mainland Chinese companies list, posted some of the worst performances of major global benchmarks. They fell 5.1% and 2.9%, respectively, amid reports that Chinese officials were moving to clamp down on the lending boom there. Those declines stand in contrast to the countries’ performance last year. As China sidestepped the worst of the recession and pushed through a large stimulus program, shares skyrocketed. The Shanghai Composite rose almost 80%; the Hang Seng jumped about 52%.

Investors obviously turned to the US during the first quarter as the DJ US Total Stock Market Index rose 5.8% versus a gain of 3.8% for the DJ Total Global Index. Even in Brazil, which enjoyed a buoyant 80% gain during 2009, the US Index outpaced the Bovespa which gained 2.3%. The Dow also increased at about the same rate as major pan-European indexes. The Stoxx Europe 600 rose a respectable 4.1%. Still, the problems with Greece, which is running heavy budget deficits and struggling to refinance its hefty debt, weighed on the stock markets of several countries. At its first-quarter closing low on Feb. 8, Greece’s ASE Composite Index was down 17.8% from its level at the end of 2009. But the index clawed back some of those losses as euro-zone members cobbled together an agreement in March to provide backstop loans for Greece in combination with the International Monetary Fund. It finished the quarter down 5.9%. Other nations thought to face somewhat similar fiscal straits also saw declines. Spain’s IBEX-35 dropped nearly 9%; Portugal’s PSI-20 lost 4.3%. Not all major European indexes fared that poorly. The U.K., Germany and France all finished the quarter higher, although the pace of gains for Germany and France slowed down from the end of 2009. France’s CAC-40 rose just shy of 1% during the quarter, compared with 3.7% during the fourth quarter. Germany’s DAX added 3.3%, as opposed to 5% during the fourth quarter. The British FTSE 100 gained 4.9% during the first quarter, versus 5.4% during the fourth quarter.

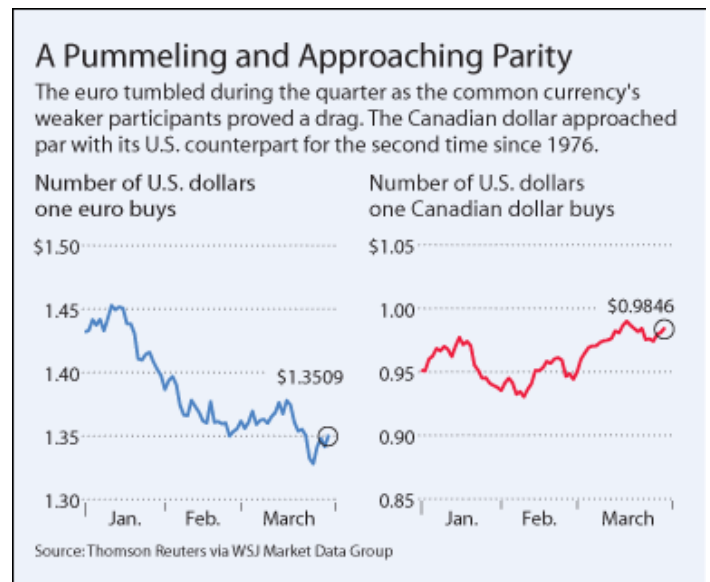
Commodities

After gaining 19% for 2009, the DJ-UBS Commodity Index fell 5% during the first quarter of 2010. In late January, as sovereign debt levels in Greece, Spain and Portugal raised concern of austerity and possibly default, investors rushed to the “safe-haven” of the US dollar and drove commodities prices down; at one point the DJ-UBS Index was down as much as 13%. As the debt concerns eased, commodities recovered somewhat but the rise was blunted as several Asian countries raised interest rates and took other steps to cool their economies. Restrained by these uncertainties many commodities, including oil and gold, traded within a narrow range for the period.

Oil prices were supported by increasing fuel consumption but capped by still-high inventories. Oil spent the entire first three months moving between \$71 and \$84 a barrel. Gold, after hitting an exchange-record high in December 2009, had the quietest quarter since June 2008. The precious metal bounced between \$1,052 and \$1,151 per troy ounce, amid the dueling forces of subsiding recession fears and increasing demand for jewelry. At the end of the quarter oil stood at \$83.76 a barrel up 6%. Gold had tacked on 2% and stood at \$1113.30 an ounce. All eyes remain on China, the world’s fastest growing economy and the largest consumer of raw materials.

Credit

The largest variable in coming months is how and when the US government will withdraw the extra financial support that it injected into the economy over the course of the past year and when the Fed will begin to push interest rates higher. In spite of these concerns, and an uncertain economic outlook, credit markets were strong for the first quarter of 2010.



After risk premiums, the difference between interest rates on corporate bonds and Treasuries, fell to two-year lows during the first two weeks of 2010, they began to rise again. The riskiest assets were hit hardest. During a two-week span in early February, investors took \$1.9 billion from mutual funds investing in speculative-grade, or junk-rated, bonds. Those funds had added an average \$410 million a week since April 2009, when a nearly uninterrupted streak of inflows began.

For the quarter, U.S. corporate investment-grade issuance totaled \$225 billion, the most since the second quarter of 2009, but down from \$344.9 billion in last year's first quarter. High-yield issuance reached \$67.9 billion. It was just \$11.3 billion in last year's first quarter, when the high-yield market was mostly frozen by the financial crisis. Both investment-grade and high-yield deals performed well in secondary-market trade, indicating underlying strength in demand, as well as the effects of large-scale government stimulus efforts.

The Fed has obviously been the largest factor, effectively printing \$1.7 trillion to purchase fixed-income assets. When the Fed sets interest rates a zero, those investors needing to generate income are forced to shift money further out on the risk spectrum and much of it has gone into investment-grade and high-yield funds. Most Treasury offerings were eagerly purchased until last week, when three large note sales met with mediocre demand. That helped push up Treasury yields, which move inversely to prices. The 10-year Treasury yield stood at 3.837% at the end of the quarter, compared with 3.834% at the end of 2009. It dipped as low as 3.546% in early February.

The potential for interest rates to rise significantly is perhaps the biggest worry for holders of corporate bonds, because rising rates hurt the value of existing bonds. But despite the government's borrowing spree, coupled with uncertainty about how and when the Fed will eventually withdraw stimulus funds from the economy, those fears seem somewhat contained for now.

Mergers

Although many had predicted a fresh wave of merger announcements after the late 2009 surge, activity was muted during the first quarter of 2010. Global merger and acquisition activity totaled \$650 billion in the first quarter, down 3% from 2009's fourth quarter. A number of investment bankers indicate that they are optimistic that the worst of the M&A downturn is behind us, showcasing recent big deals such as Coca Cola's purchase of the bulk of its largest bottler for \$12 billion, announced in late February.

The quarter's big regional story was in Asia, where volume, outside Japan and the Australia region, jumped to \$115 billion, compared with \$37.7 billion a year ago. The number of deals rose 8% to 1,528, compared with 1,416 in the first quarter of 2009.

The total amounts to 25% of global deal volume in the first quarter, up from 15% in the first quarter of 2009. That makes

four consecutive quarters when Asia has been 25% or more of deal activity, compared with about 15% in previous years.

In the U.S., first-quarter deal volume fell 12%, to \$217.6 billion, compared with \$248.2 billion a year ago. The number of deals rose 26%, to 2,356, compared with 1,866 deals in the first three months of 2009.

In Europe, which has been slow to shake off recession, deal volume fell 7%, to \$154.3 billion, compared with \$166 billion a year ago. The number of deals fell 15% to 3,105.

Deal makers in Europe cite a number of factors for the sluggishness. Some say big European banks are more reluctant to lend to support deals than their counterparts elsewhere, in part because they still hold toxic assets that in some cases mightn't have been written down sufficiently. And economic and financial woes persist in Europe, evidenced most recently by Ireland's banks' need to raise tens of billions to shore themselves up. Among the quarter's largest deals globally were U.K. insurer Prudential PLC's acquisition of the AIA life-insurance unit of AIG for \$35.5 billion; oil-field-services provider Schlumberger Ltd. buying rival Smith International Inc. for \$11 billion; and Heineken NV buying Mexican beer maker Fomento Economico Mexicano SAB, or Femsa, for \$5.46 billion. MetLife also agreed to buy AIG's second-largest foreign life-insurance business for \$15.5 billion.

As we move further into 2010, the investment landscape continues to be interesting. We welcome your questions and comments and as always, appreciate the opportunity to be of service.