

FLIPPIN, BRUCE & PORTER, INC.

INVESTMENT COUNSEL

MARKET COMMENTARY

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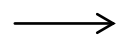
Equity markets exhibited significant volatility during the second quarter. Stocks advanced to 52-week high levels in early May, then slid 8% over the next 45 days before finally ending the quarter with four strongly positive days. Ultimately, stock market index returns were near zero percent for the quarter, but it was a bumpy ride along the way.

We were somewhat surprised that the market plowed ahead in the first quarter in the face of the turmoil in the Middle East and the disaster in Japan. It appears that investors did react to these events; the reaction was just delayed a bit into the second quarter. There always seem to be reasons for investors to worry and recently more reasons surfaced than usual. First and foremost was the economy. At its June meeting, the Fed modestly lowered its projections for GDP growth in 2011 and 2012. The second round of the Fed's stimulative bond purchases, known as QE2, ended as the quarter came to a close. The end of this action was met with uncertainty surrounding whether the lack of that stimulus would slow the economy later this year. Commodity prices remained elevated, although several, including cotton and oil, pulled back from their recent highs. Coordinated global releases of strategic oil reserves late in the quarter helped to lower crude prices. The news on the U.S. housing market continued to be bleak with the S&P/Case-Shiller home price index remaining below levels of a year ago despite some pockets of strength, for example the Washington DC metro area. Add to that the stalemate in Congress regarding lifting the government debt ceiling and riots in the streets of Greece in the face of forced austerity measures and you have the recipe for market turmoil.

Even knowing these concerns, we believe the economy will move forward with positive, but uneven, growth. Furthermore, we do not believe a second recession is likely. Interest rates remain very low. Unemployment is still stubbornly high, but has inched downward from its recessionary high. The impact to the supply chain from the Japanese tragedy is already subsiding and that economy is expected to stage a strong recovery as the year progresses. Domestic auto production should show a rebound in this quarter, which will provide a nice lift to the economy. Slow-but-steady economic growth in the U.S. has brought about marginal improvement in consumer confidence and has helped to strengthen corporate balance sheets. It appears that equity investors are becoming less fearful that the economy will roll back into recession; stock prices seem to have digested the risk factors and have resumed an upward trend in recent weeks. Our outlook for the equity markets for the second half of 2011 and into 2012 remains positive.

Our performance for the quarter was below our expectations as the portfolio failed to keep up with the indexes. This was especially evident in the Information Technology and Industrials sectors. Several companies announced disappointments during the quarter, resulting in weak returns. However, these stocks are now trading at significant discounts and we believe offer excellent return potential as the companies execute their respective business plans. Because these companies are deeply out of favor with investors, sentiment should improve markedly at any sign of fundamental progress.

Information Technology, once one of the most highly-valued sectors in the market, has generally lagged over the last few years as investors came to grips with the fact that growth rates for



these companies have been declining. However many of them have strong global market positions, pristine balance sheets and are still growing and generating huge amounts of cash. And the stocks are very inexpensive. Our holdings in the Information Technology sector currently trade at only 8.2 times forward earnings estimates, well below both their long term average and the 12.5 times level of the market. As investor expectations for worldwide economic recovery have subsided, we believe we have a rare opportunity to own some of the strongest companies in the world at very compelling prices. In addition to the cash-generating ability of these companies, share repurchases at these depressed valuation levels should help bring about increasing business values each year. We believe these stocks are poised to move sharply higher once other investors come to share this view.

Currently, about one-third of our portfolio is invested in the Information Technology and Industrials sectors. Many of these stocks, which we have carefully selected, appear to be selling at substantial discounts to their true value. That is not unusual in times of heightened uncertainty. The pervasive pessimistic outlook that surfaced last quarter gave us several opportunities to add to our positions in these economically sensitive sectors. Overall, the portfolio is trading at valuation levels well below the market and at a 24% discount to our estimated values, a larger-than-normal discount. We believe our portfolio is well positioned to benefit once the economic recovery becomes more evident.

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