CORE EQUITY PORTFOLIO REVIEW

Third Quarter 2010

MARKET COMMENTARY

It never fails: as soon as the business press calls attention to a particular historical characteristic or trend relating to the performance of the U.S. stock market, the opposite is bound to occur. Such was the case this past month. After touting the fact that September is historically a difficult month for the equity market, numerous media sources proffered various remedies for what investors might do to protect themselves. Woe to those who swallowed that advice! The stock market did just fine in September, with the S&P up 8.9% for the month and carrying the quarter to a positive 11.3% finish. While September's strong showing may have muted the cries of the 'September Slump' theorists, it did nothing to mute the volatility swings that have characterized the market's behavior so far in 2010…or for the last three years for that matter. July showed strong performance after a dismal June, but August followed with weak price movement.

Can any wisdom be drawn from the volatility of the market over the past several months? World securities markets generally have been reflecting the fact that the strong economic rebound of 2009 is moderating, especially in developed countries such as the U.S. The markets' tendency to seize any and all pieces of economic news and to draw secular conclusions from single data points has led to manic price rushes both up and down. Our observation, certainly not unique, is that the remarkable credit-fed U.S. consumer of the mid-2000's remains constrained by outstanding debt in 2010, as are small U.S. businesses that rely on internal cash flow and back-supplied credit. This continues to limit the activity of U.S. small-businesses, normally a prime source of employment. Things are quite different (better) however in other parts of the world, and therefore for those companies exposed to these higher growing regions no matter where their headquarters are domiciled. Consequently U.S. companies that have exposure to markets in developing countries continue to experience nicely growing sales. Combined with very accommodating bond markets, the outlook is actually quite positive for publicly traded U.S. companies, especially those that can tap the securities markets for additional capital. Remarkable still is the Fed's policy: we are amazed by the current stance of the U.S. Federal Reserve, and wonder why markets everywhere aren't zooming up. But the aforementioned credit squeeze on consumers and small businesses is keeping the fabulous amount of liquidity on bank balance sheets, including those of foreign central banks.

When will we break out of this lethargy in the U.S.? There is some reason for optimism…faint, but real. In the early stages of a typical recovery, economic productivity is high as companies' revenue and income rise with their greater utilization of unused capacity created by the slowdown. However, as economic activity picks up, productivity declines as overtime and other expensive tactics to extend capacity are employed. It seems that because U.S. companies are still ill-at-ease in the current economic environment, they are doing everything in their power not to hire full time equivalent employees. Yet at some point, they must begin hiring – they have to – and when that time comes, it will mean higher consumer income. We do not expect a mad employment rush, but a steady increase in employment, especially in skilled jobs.

PERFORMANCE NOTES

	Periods Ending Septermber 30, 2010					
	Quarter	Year-to-date	1 Year	3 Years	5 Years	10 Years
Core Equity Composite – NET	**10.3%**	**7.2%**	**12.6%**	**0.0%**	**4.7%**	**5.4%**
S&P 500 Index	11.3%	3.9%	10.1%	-7.2%	0.6%	-0.4%

Composite performance is reported **NET** of fees and expenses. Please refer to the disclosures at the end of this report.

The return characteristics of our Core Equity investment strategy remain true to form for the last three months and year-to-date: the portfolio lagged slightly behind the market's strong third quarter, as should be expected from a strategy with a conservative bias, but on a year-to-date basis remains well ahead of the market average as a result of outperforming when the markets were weak.

There were a number of bright spots in the portfolio during the quarter, including **Rovi (ROVI)** up 33%, **DuPont (DD)** up 30%, **Ladish (LDSH)**, up37%, and even stodgy old **Verizon (VZ)** up 27%! We've written about Rovi and Ladish in recent quarterly reviews, and will spare you a repeat of those discussions. The sizeable price gains by DuPont and Verizon have a common theme, though DuPont has an interesting subtlety to it. As bond yields have crept lower – the 10-year U.S. Treasury yield is a whopping 2.5% - there has been more and more enthusiasm (finally) for buying the 'big uglies', i.e., the very large U. S. companies that inhabit some classically high dividend paying sectors such as energy, industrials, and telecommunications services. And why not? If an investor can stomach some volatility, the better-than-bond yields plus the high probability of at least moderate growth in those dividends makes these better longer-term investments than bonds at current yield levels. Verizon has been a beneficiary of this trend.

DuPont has other positive attributes beyond a high and growing dividend and improving trends in its cyclical chemical business. When we first looked at DuPont in early 2008, we were attracted to it for one reason: its seed business. Among seed producers, DuPont's Pioneer Hi-Bred unit has been the far less sexy sibling to Monsanto's DeKalb unit. Monsanto has innovated its way to the top spot in terms of market share, but is regarded with mixed emotions by the farming community due to too frequent price increases along the way. Although farmers felt they had to buy Monsanto's products, they never really liked doing so. Put another way, a Midwest farmer would generally spit on the ground when he saw the Monsanto salesperson walking up his driveway, but would actually invite the DuPont salesperson into the house for a cool drink. The first indication that DuPont was starting to compete head-to-head with Monsanto was in 2009. DuPont was able to field some seed products that ultimately took some small market share away from Monsanto. DuPont may still be recognized as the ugly sister when comparing scientific acumen, but it has begun to prove that it is capable, and importantly, the company is intelligently using both price and product to its advantage. We believe the stock's strong showing this past quarter is in part due to the market catching up to our outlook for DuPont's seed business.

At the low end, we saw relatively poor performance out of **Sara Lee (SLE)**, down 4% for the quarter, and **Martek Biosciences (MATK)**, down 5%. It is tempting to say that this was simply a reaction to the rewarding performance from both companies in the first half of 2010, when Sara Lee was up 17% and Martek was up 24%. But it is not that straightforward, especially in the case of Martek. We noticed in September the signs of a rotation by portfolio managers, yet again, out of low-risk and into higher-risk stocks. As a result, historically more stable stocks such as consumer staple companies (of which Sara Lee is an example) were sold to fund the purchase of riskier names which include smaller, younger companies or those companies more exposed to the impact of the economic cycle on sectors such as mining, energy, industrials, and consumer discretionary.

Martek's story however is a bit more complex. We have always been interested in Martek due to the strength of its research and product development. The company commercialized its research in the area of food additives over the past decade, specifically an additive called DHA. DHA has been shown in numerous clinical studies to aid in brain development, and Martek's product is particularly well-suited to the food additive market. In fact, a large portion of Martek's sales are to baby formula producers who add Martek's DHA to their products. The negative on the horizon for Martek relates to the sustainability of one of the competitive advantages in its business model. A patent covering one element of Martek's DHA processing technology is due to expire in 2012. Thus there is the potential for pricing risk in Martek's DHA additives versus competitors. We have in the past been willing to continue to hold stocks of companies with important patents about to expire, IF our expectation was that the company would be able to make up the difference in increased sales in other products, would be able to offset the price drop with volume increases or through cost cutting measures, or a combination of all three. Experience says this is a difficult task to manage, even if we believe the potential damage to revenues and income is already embedded in the price of the stock. From our discussions with parties both inside and out of the company, we believe it will be no easy task for Martek to secure long-term sales deals with somewhat tolerable pricing from its four primary baby formula customers (though the company has secured a contract with one of them). Additionally, pressure is building on the company's non-formula additive business which has been growing steadily of late. If management can secure contracts similar to the ones it already has while executing its growth strategy in the non-formula areas, the stock is certainly worth holding given its return potential and current valuation. However, the risks to the historically beneficial trends helping Martek are rising. The stock remains in Core Equity portfolios, but on a short leash.

PORTFOLIO ACTIVITY

Major portfolio changes this quarter include the sale of two smaller positions and the establishment of a new, larger one. Specifically, we sold **AT&T (T)** and **FEI Company (FEIC)**, and bought shares of **AMETEK (AME)**. The trades were as much for portfolio construction reasons as for fundamental (trend, business model) or valuation reasons. Recall that in order to deliver both outperformance and capital preservation, we are attracted to two types of stocks in our Core Equity strategy: those that are more growth oriented, and those which might provide less growth over a market cycle but are more stable, providing downside protection. FEI, one of the portfolio's small-capitalization names, was a growth holding, while the large-cap AT&T was held for its stability. AMETEK, a mid-cap name, is a growth holding, but we also expect that it will provide greater stability than other stocks with similar growth potential.

AT&T and Verizon have both been Core Equity portfolio holdings for a few years, to provide stability and a decent total return. As expected, these dividend paying, blue chip stocks did indeed deliver some important support to the portfolio during the dark days of 2008, but were flat during the market updraft in 2009. Though we still believe AT&T and Verizon to be solid alternatives to a bond investment, we think one name in the portfolio provides sufficient exposure to the wireless service business, and see Verizon emerging as the better operator. (Refer to our Fourth Quarter 2009 Core Equity letter for further insights into Verizon vs. AT&T.)

FEI is a capital goods company that produces specialized instruments used in laboratory research and electronics manufacturing that requires extremely fine measuring tools. (The process of examining and manipulating materials at elemental levels is described as microscopy.) Specifically, FEI makes focused ion beam systems, scanning electron microscopes, and transmission electron microscopes. Some of FEI's advanced instruments provide atomic-level resolution. We purchased FEI shares a year ago, expecting to see the stock buoyed by a near-term upswing in semiconductor equipment manufacturing and a longer-term increase in the investment in scopes by biologic research labs. The manufacturing upswing unfolded right through the recent second quarter, but life science bookings have not been as strong as we were expecting. We still believe demand from life science labs is in the offing, but not soon enough to offset the coming decline in semiconductor equipment buying off its recent peak. The downside potential of FEI moved beyond our comfort zone for Core Equity portfolios, leading to a sell decision.

AMETEK is a diversified industrial in the spirit of Danaher, though smaller. Helmed by CEO Frank Hermance, AMETEK manufactures monitoring, testing, calibrating, and display instruments that are sold across numerous industries: aerospace, power generation and transmission, truck manufacturing, chemical, semiconductor manufacturing, and refining. Just under 50% of AMETEK's revenue is sourced from non-U.S. markets. Hermance's primary operating strategies are continuous manufacturing improvement, global expansion, new products, and acquisitions. AMETEK's business model is attractive to us not just for its ability to grow business lines successfully, but because the company has proven its ability to profitably assimilate business acquisitions. Management's systemization of the acquisition process translates into greater cash generation utilizing modest growth from overseas markets – especially in industrial products sold into the aerospace, power generation and transmission, and chemical processing industries. Given the diversity of AMETEK's product line and the essential nature of its industrial products, we expect AMETEK's sales and earnings to be less cyclical than FEI's.

LOOKING AHEAD

There has been much discussion surrounding this fall's elections, and for good reason: they're quite important. In the past two years, the current administration and Congress passed legislation that will not only necessitate higher taxation in the future, but also introduces regulatory obstacles to private industry with little in the way of more effective oversight of those industries. Like many, we expect the Republican Party to reclaim some of the representation it lost in the last Presidential election, but we all must wait to see what legislation actually makes it out of Congress and is signed into law. We doubt we're going to rush out and make big moves the day after the elections.

What would we like to see from Washington pertaining to economic matters? First, we hope to see the Bush tax cuts, set to expire at the end of this year, maintained. It is imperative that the current rate structure be preserved while the economy continues its slow recovery. A second subject of concern is trade. There seems to be an increasing level of belligerence in the trade and currency talks between China and the U.S. We agree that China should allow its currency to rise, but for the U.S. to pick a fight with China right now seems unwise. Trade sanctions potentially used by both sides to induce a change in currency value would act as a tax on both economies. If this November's elections result in a more even playing field between the two parties, we can only hope that it will lead to less rhetoric and more sober discussions concerning the towering twin issues of taxation and trade. If taxes are allowed to rise and trade sanctions become a reality, it would in our opinion foster an environment less conducive to growth. Though we never promise anything, a more conservative handling of our clients' equity portfolios is our likely reaction.

DISCLOSURES: The Core Equity Composite is comprised of discretionary taxable and tax-exempt accounts of similar risk and investment objectives that are managed according to Princeton Capital Management's conservative, equity oriented investment strategy. Prior to 1/1/09 this strategy and its composite were marketed as Princeton Capital Management's Growth and Income investment product. While the strategy has not changed, it was renamed to reflect its intended strategic role within an investment program. Accounts are included in the composite at the beginning of the first full calendar month each account is fully reflective of the investment strategy. Results are calculated internally using Advent portfolio accounting software and information provided by outside custodial firms. Composite and index performance valuations and calculations include dividends, interest and other earnings and are stated in US dollars. Performance figures for periods one year and longer are annualized. Composite returns are asset weighted and are reported net of fees and commissions. Performance results for individual accounts may vary due to the timing of investments, size of positions, fees, and other reasons. A client's returns may be reduced by other expenses incurred in the management of the client's portfolio. Additional information regarding policies for calculating and reporting returns is available upon request. PAST PERFORMANCE SHOULD NOT BE CONSTRUED AS A GUARANTEE OF FUTURE PERFORMANCE. The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and the reader should not assume that investments in the securities identified or discussed were or will be profitable.

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