Year-End Earnings Report

February 2011

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With year-end 2010 earnings numbers in for most of the companies in your portfolios, it is hard to think of a good enough adjective to describe them. "Tremendous" certainly does it. So does "amazing" and "excellent." You get the point. The companies we owned at the end of January had profit growth far exceeding what was expected from them at the beginning of the year. The year-end earnings report gives investors, and we consider ourselves investors instead of traders, the best picture possible on how firms are doing. While markets and stocks fluctuate over the short-term depending on investor psychology and day-to-day economic or political news, over the long-term there is a clear link between earnings and price.

For the overall market, 2010 was a strong year for earnings growth. With most of the data in, several investment banking firms expect companies in the S&P 500[1] to have aggregate earnings of $84 per share in 2010. This represents an increase of 47% over the depressed 2009 figure of about $57 per share. Revenues for the S&P 500 increased 6%-9%, depending on the source, over 2009 levels. For 2011, they expect the S&P 500's earnings per share to be about $96, up a very respectable 14%. Revenues are expected to grow 6%-8%. Some of the most robust earnings growth in 2010 came from companies in depressed sectors, such as banks, rebounding after dismal results in 2009.

In general, companies in our large cap portfolios posted excellent 2010 results as well, reflecting several factors. The economy improved over 2009 levels. During the recession many companies were extremely vigorous in cutting costs, so as the economy improved in 2010, revenues grew again, often by double digit rates, and the prior year cost-cutting allowed more profits to fall to the bottom line. The 40 firms in our large cap portfolio on January 31st had average earnings growth of 43% in 2010 on revenue growth of 18%

Large Cap. Portfolio Sector (No. of Stocks)	Earnings Growth	Revenue Growth	Est. 2011 EPS Growth
Consumer Discretionary (8)	32%	8%	15%
Consumer Staples (1)	14%	11%	10%
Energy (5)	35%	25%	30%
Health Care (5)	27%	12%	14%
Industrials (5)	58%	18%	21%
Information Technology (10)	59%	27%	17%
Materials (5)	43%	15%	17%
Telecom (1)	59%	9%	18%

The recovering economy meant better results from the stocks we held in the consumer sectors, especially in the consumer discretionary group. Stocks in the group showed exceptional earnings growth in 2010 ranging from 9% for McDonald's to about 63% for DIRECTV and 60% for Starbucks, the ubiquitous coffee chain. Revenue growth from the group ranged from flat to up 13%. Our sole consumer staples stock at month-end was the Coca-Cola Co., which had respectable earnings growth of 14% on revenue growth of 11%. The company completed the acquisition of Coca Cola Enterprises' North American bottling subsidiaries in October. This will make 2011 comparisons difficult but 10% earnings growth is expected.

At the end of January, we owned five energy stocks. On average, they had earnings growth of 35% in 2010 on revenue growth of 25%. But their range was substantial, ranging from 3% growth for oil service firm Schlumberger to 89% growth for oil producer Chevron. More importantly, the companies should have 30% earnings growth on revenue growth of better than 20% in 2011 driven by higher oil prices worldwide and the growth of new drilling technologies both in North America and abroad that use more services and products than prior drilling techniques.

Health care stocks, in general, are known and bought for their stability as much as for their growth. The five in your portfolios provided both in 2010, averaging earnings growth of 27% on revenue growth of 12%. Earnings growth for the companies ranged from 19% to 39% on revenue growth of 5% to 21%. The leader in growth was Novo-Nordisk, a Danish firm that is one of the world's leading producers of insulin and other diabetes medicines. We expect more modest, but still acceptable, 14% average earnings growth from the group in 2011 with generic drug producer Watson Pharmaceuticals likely to post 20% growth as it benefits from Pfizer's Lipitor going "generic" in late 2011.

In terms of earnings growth, one of the two best sectors for us in 2010 was the industrial sector. The five stocks we owned in that sector had average earnings growth of 58% in 2010 on revenue growth of 18%. The low earnings growth figure was 27% while the high was more than 100%. The sector was somewhat still recovering from the 2008-9 downturn. However, it also benefited from growing demand for commodities both agricultural and mineral worldwide. Profit margins improved immensely for the group. The top earnings grower for us was Cummins, Inc., the manufacturer and servicer of diesel engines worldwide, with earnings growth of more than 100% on 23% revenue growth. Many of the company's products are used in fast-growing emerging markets and are used in fast-growing industries such as mining and agriculture in those areas. Deere and Union Pacific benefited from the growth in both mining and agricultural industries as well.

Technology stocks, the largest part of our portfolios at the end of January, was the sector with the best earnings growth in 2010. The 10 stocks in the portfolio posted average earnings growth of 59% in 2010 on revenue growth of 27%. The slowest growth of our stocks in the sector was I.B.M.'s very respectable 15% growth while two companies, chip maker Altera, and consumer electronics maker Apple posted earnings growth of 177% and 141% respectively. While Altera's growth was helped by a somewhat weak 2009, the same can't be said for Apple. Earnings more than doubled helped primarily by new products such as the iPad and newer versions of existing products such as the iPhone and iPod. The technology stocks we own should have average earnings growth of 17% in 2011 again led by Apple.

Due primarily to the improving global economy, material stocks enjoyed a tremendous rebound in earnings in 2010 versus 2009. The five stocks we owned in the sector had average earnings growth of 59% last year. Due to strong copper and gold prices, Freeport Copper & Gold had the strongest earnings growth in the group at 69% on revenue growth of 26%. The company's earnings should grow another 23% in 2011. More mundane, but still substantial, earnings growth of 14% and 20% respectively was posted by industrial gas producer Praxair, Inc. and packaging company Ball Inc.

Lastly the sole telecom stock we own, American Tower, had 9% revenue growth but 59% earnings growth in 2010 as it benefited from having additional towers and additional usage of its towers.

In retrospect, the earnings growth our companies had in 2010 was far better than expected when the year began. It is fair to say the growth they experienced last year probably won't be repeated in 2011, but the 20% growth we expect remains substantial, especially since they are selling for about 16x earnings. This compares with the S&P 500, also selling for about 15x earnings, but "only" having 14% earnings growth expected for 2011. We continue to believe there is good value in our stocks as we begin the year.

Note: Our Tax-Exempt Large-Cap Institutional Equity composite companies were used for table above. Sources: S&P, Value Line, Wm. O'Neil, company data.

Past performance is no guarantee of future results. Upon request, Chase Investment Counsel Corporation will provide a complete list of holdings on Jan. 31, 2011 and a list of all recommendations made during the twelve months ended Jan. 31, 2011.

[1]The S&P 500 Index tracks the stocks of 500 U.S. Companies. You cannot invest directly in an index.