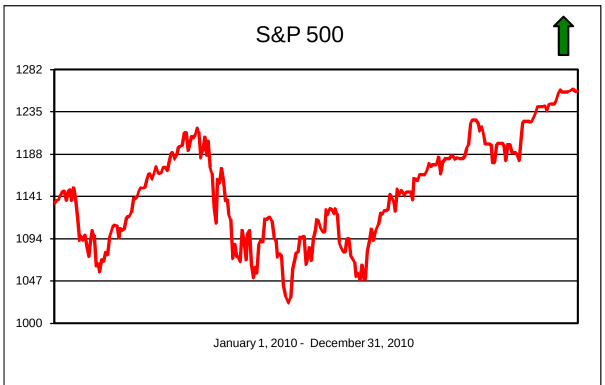
WALLINGTON ASSET MANAGEMENT

INDEPENDENT INVESTMENT COUNSEL

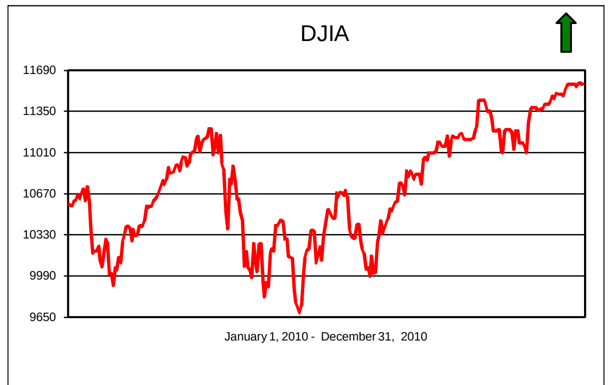
QUARTERLY REVIEW ***88th Edition*** ***2010: Fourth Quarter***

CAPITAL MARKETS SCOREBOARD

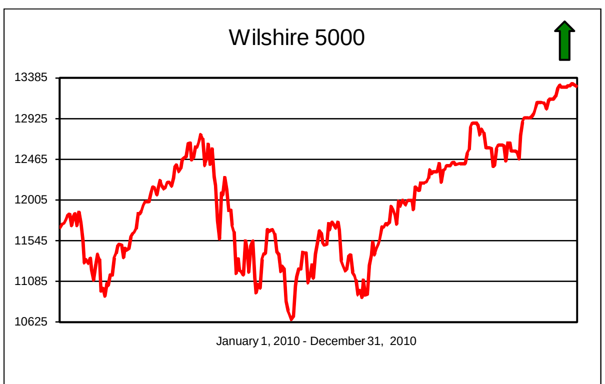
January 1, 2010 – December 31, 2010



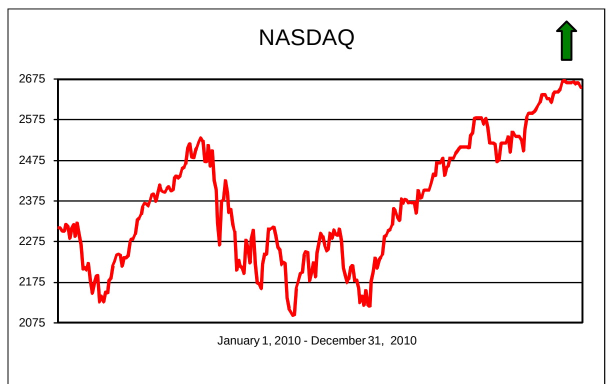
4th Qtr 10.76% YTD 15.06%



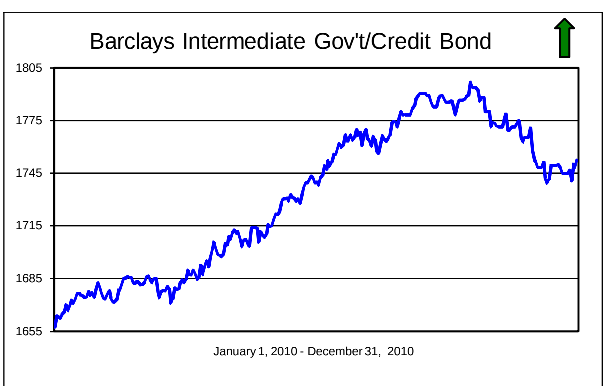
4th Qtr 7.32% YTD 11.02%



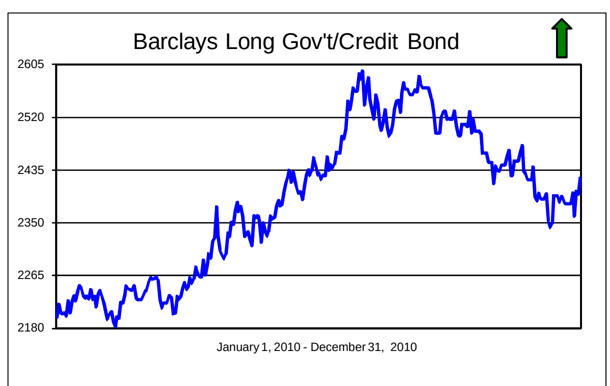
4th Qtr 11.24% YTD 15.59%



4th Qtr 12.00% YTD 16.91%



4th Qtr -1.44% YTD 5.89%



4th Qtr -5.60% YTD 10.16%

EQUITIES

Equity Market Performance

The Standard and Poor's 500 Equity Index (S&P 500) finished 2010 in a unique fashion, with all sectors posting positive returns (see chart). This has happened only twice since 1960. After bottoming out in early July, the market posted two strong quarters of 10%+ returns to provide a price return of 12.8% for 2010. The S&P 500 closed at 1258.76, while the Dow ended the year at 11,577.51.

S&P 500 by GICS Sector	Price Return (%)	
	4Q10	**YTD**
Energy	20.9	17.9
Materials	18.5	19.9
Consumer Discretionary	12.2	25.7
Industrials	11.2	23.9
Financials	11.2	10.8
Information Technology	10.0	9.1
Telecom Services	5.9	12.3
Consumer Staples	5.3	10.7
Health Care	3.1	0.7
Utilities	0.0	0.9
S&P 500 Index	**10.2**	**12.8**

The S&P 500 outperformed the developed international markets as investors avoided the Euro due to debt problems in Greece, Ireland and then Spain. The Morgan Stanley Capital International (MSCI) Europe, Australasia, and Far East (EAFE) Index advanced 8.5% for 2010. Outperforming the major developed markets, the MSCI Emerging Markets Index continued to produce strong gains with a price return of 14%.

Third Quarter Earnings Review and Fourth Quarter Preview

According to Citigroup Global Markets, as of December 31, 2010, of the 495 companies reporting their earnings for third quarter 2010, approximately 71% reported a positive surprise, 19% reported negative surprises and 10% reported in-line results. The companies in the Information Technology, Industrials and Health Care sectors showed the greatest percentage of positive surprises, while the Utilities, Materials and Telecommunications sectors showed the greatest negative surprises. Even with the jobless rate at 9.4% and home foreclosures reaching a record high in September, corporate earnings are very good in most sectors. Many of the large multi-national corporations credited international demand as they reported higher profits and raised forecasts.

Fourth quarter earnings will be reported over the course of the next few months. Alcoa marks the beginning of the earnings season, reporting results on January 10. According to Wall Street analysts, S&P 500 companies will report year-over-year earnings growth of 32% in the fourth quarter. The Financials, Materials, and Energy sectors have the highest projected growth rates for the quarter, with the Utilities sector being the only sector expected to post a decline in earnings compared with last year. All ten sectors are predicted to report revenue growth for the quarter. The overall revenue growth rate for the S&P 500 in the fourth quarter is expected to be 6%.

Social Media Update

Facebook Raises Half a Billion Dollars, Has Thousands of Investors, Still Avoids Securities & Exchange Commission (SEC) Scrutiny…

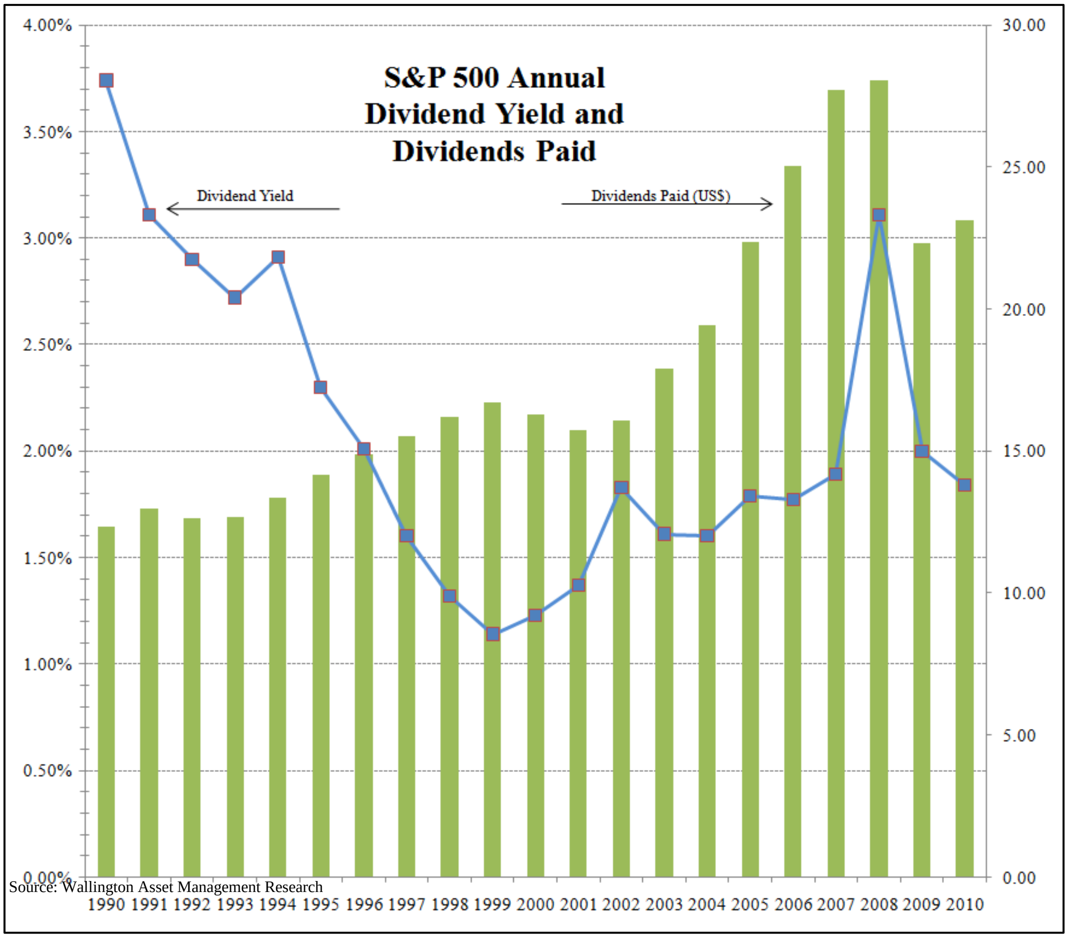
A mutual fund consolidates investor monies into a single pool and then generally purchases a significant number of securities for the benefit of its customers. Hedge funds consolidate investor monies into a single pool and purchase securities for the benefit of their respective clients. Innumerable private partnerships, advisors, et al operate on the same principle. Goldman Sachs' recently-created proprietary fund, which consolidated investor funds into a single pool and purchased securities for Goldman's clients, therefore, does not seem particularly worthy of the SEC attention except for the fund's concentration. The *only* investment in this pool is the privately-traded company, Facebook. Goldman's fund has made the news and garnered the SEC's scrutiny because privately-held companies are limited to 499 investors; the 1964 rule is meant to shield investors from any potentially fraudulent behavior of non-public companies. Yet thousands of investors now have economic exposure to Facebook through a *special purpose investment vehicle (SPV)* that holds a significant equity stake in a company that is under no obligation to disclose its business practices or financial situation. The last point is the source of the SEC's consternation, because human nature virtually guarantees that someone somewhere will eventually defraud hundreds or thousands of people using this type of investment template.

…While Myspace Contemplates Its Future.

In contrast to Facebook's success, its erstwhile competitor, News Corporation-owned Myspace, announced on January 11, 2011 that it would lay off 47% of its employees. Myspace's fortunes have declined precipitously since News Corp. paid $580 million for the company in 2005 – its latest customer count ("unique U.S. visitors") was down 15% year-over-year to 54.4 million compared to Facebook's 50% year-over-year gain to 151.7 million. News Corp. is evaluating all options for the struggling line of business.

Dividend Increases Likely

Improving earnings have helped companies raise their dividend payouts in 2010. In 2011, more dividend increases are expected. Of the companies that make up the S&P 500, 248 increased dividends in 2010, paying investors $207 billion, an increase of 5.6% over 2009. Senior Index Analyst Howard Silverblatt at S&P Indices expects the amount paid to investors to grow another 8% in 2011. Silverblatt estimates that over half of the S&P 500 companies will pay out more in regular cash payments in 2011 than they paid in 2010. Given the uncertainty of the economy and the market, that statement is a powerful endorsement of the upward trend for dividends.



Source: Wallington Asset Management Research

Look for more dividend increases from financial firms which had the biggest cuts during the financial crisis. Bank of America slashed its dividend from $.64 per share each quarter to its current one penny. Fifth Third slashed its dividend to one penny and JPMorgan, considered one of the strongest financial companies, has a five cent payout – down from the $.38 a quarter it paid in 2008.

Other sectors, such as Consumer Staples, have paid very consistent dividends during the crisis. Companies such as Pepsi Inc. and Kimberly Clark Corp. are expected to maintain their track record in 2011.

Investors received more good news in December when both houses of Congress passed legislation extending the Bush tax cuts, which would have expired at the end of 2010. President Obama's signature preserved the 15% tax rate on qualified dividend income.

GM's Successful (Second) IPO

General Motors (GM) completed a successful Initial Public Offering (IPO) in November. It was the largest stock sale ever, bringing in over $23 billion. Just 17 months prior, on June 1, 2009, GM filed Chapter 11 bankruptcy after posting accumulated losses of $88 billion since 2004. The company received a bailout of $50-$60 billion from the government, earning it the nickname 'Government Motors'. With the IPO, the Treasury was able to cash out $13.5 billion of its bailout money and still retain 36% of the company.

It is estimated the Treasury will ultimately wind up taking a loss on its investment in GM, but the Obama administration sees the current valuation as very attractive compared to what they expected a year ago. The loss is considered a cheap form of stimulus and a disaster averted.

ECONOMICS AND FIXED INCOME

Fixed Income Market Performance

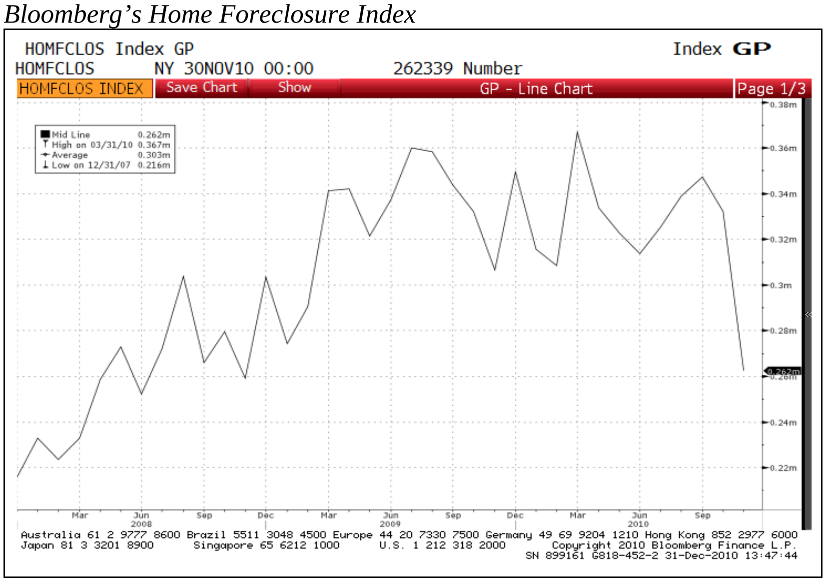
In broad terms, the fourth quarter of 2010 rewarded bond investors less than the (geometric) average return earned during the first three quarters of the year. Bank of America/Merrill Lynch's U.S. Corporate Master Index had increased for the first three quarters of the year, with each quarter stronger than the previous, but in the fourth quarter it fell 1.59%. Still, corporate bonds provided an above average total return of 9.52% in 2010. High yield bond owners earned 3.07% in the fourth quarter of 2010 resulting in a full-year increase of 15.19%. Interestingly, bonds rated BB and CCC or lower outperformed the mid-tier B-rated bonds for the year. Treasury investors gave up 2.67% of performance during the quarter, but still earned 5.88% for the year.

Municipal bonds' quarterly positive return streak ended in the fourth quarter – Merrill's Municipal Master Index declined 4.52% (it was still 2.25% higher for the year). Even though Meredith Whitney garnered quite a bit of attention for her bearish comments on 60 Minutes in December, attributing the reversal to her would be a mistake. Municipal bond prices began declining when Congress repeatedly failed to pass legislation to extend the Build America Bond (BAB) program. Consequently, municipalities pulled forward their respective timelines for issuing debt and flooded the market with new supply. Concerns regarding the health of state and local governments have not helped, of course.

Economic Pulse – U.S. Housing Foreclosures

The fourth quarter of 2010 ushered the word 'robo-signing' into the country's lexicon. Robo-signing occurs when a purported lender representative repeatedly fails to verify the accuracy of the information in a lender affidavit submitted to a court during the foreclosure process. The problem stems from the furious pace of mortgage lending (and profit making) in 2005, 2006 and 2007 that resulted in surprisingly poor record keeping, as well as the industry's Mortgage Electronic Registration System. MERS, as it is called, is a company that began operating in 1997 that uses a database of information to ease the process of handling mortgage transfers between member banks. It claims to be the mortgagee (the entity that can legally foreclose on a borrower) no matter which member bank owns the mortgage. Unfortunately, some courts do not agree that MERS has the right to foreclose. Even worse, a number of original documents were intentionally shredded after entering the MERS system in order to avoid any ownership confusion. According to Bloomberg Businessweek, this has worked to the advantage of Floridian Joseph Lents because no company can produce the proper paperwork to prove it has the right to foreclose. Lents has not made a payment on his $1.5 million mortgage since 2002. On the other end of the spectrum, Bloomberg reported that Bank of America (B of A) foreclosed on Jason Grodensky in December 2009 even though Grodensky paid cash for his home as part of a short sale from the previous owner. B of A proceeded with the foreclosure because MERS had the deed record, while the promissory note remained in paper format (with whereabouts apparently unknown).

Bloomberg's Home Foreclosure Index



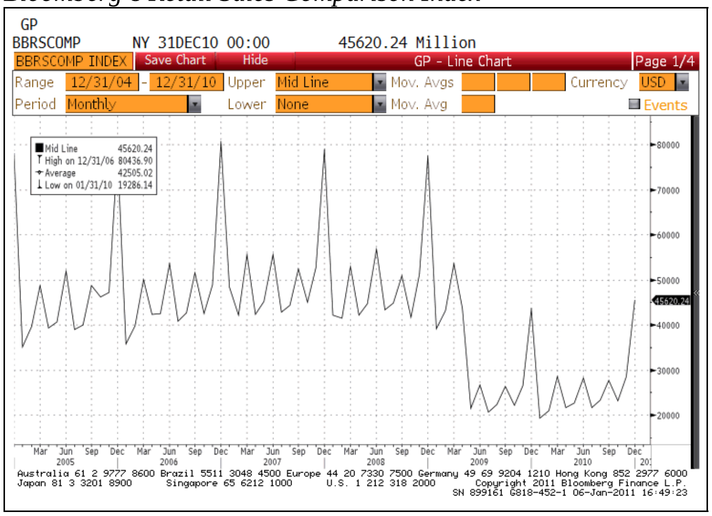
Although the fiasco generated quite a bit of press in October, and caused large-cap banking stock prices to drop, the issue faded by quarter-end. The systemic concerns were short-lived, too, as the financial sector made up lost performance ground by rallying more than any other sector in the final month of the year.

Economic Pulse – Consumers Starting to Spend

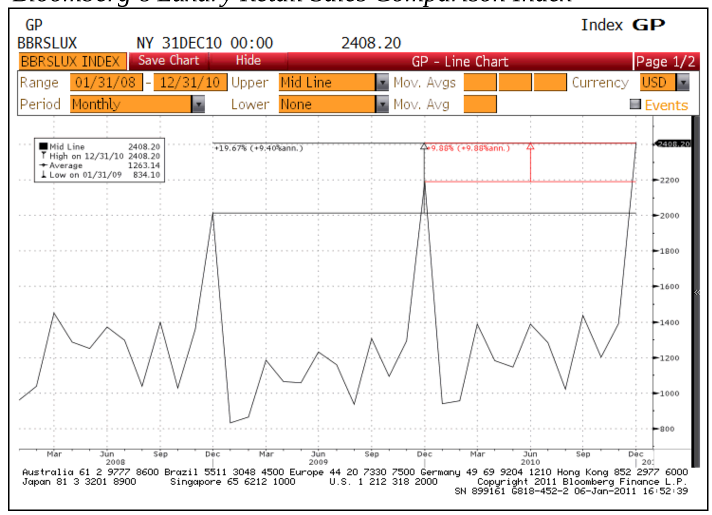
Although a number of economic indicators have improved markedly over the last two years, or even surprised to the upside, economic bears have consistently disparaged the recovery by pointing out that the consumer, once responsible for 70% of the economy, is not spending. The 2010 holiday season may finally put that concern to rest. According to various industry sources, holiday sales began posting marked year-over-year increases starting in the second week of November. Retailers saw a 5.5% increase in sales versus 2008's 6.1% decrease and 2009's 4.1% increase (implying sales exceeded 2007's level by 3.1%), while electronics sales grew just 1.2% (likely due to falling flat panel TV prices) and online sales grew an outsized 15.4% versus fairly tough comparisons. Jewelry sales rose 8.4% year-over-year and luxury products besides jewelry were 6.7% higher. Gallup conducts a poll that backs up this data; the well-known polling firm recently reported that upper-income spending rose to $183/day from $126/day for the week ending 12/26. Additionally, upper-income spending for the entire month of December was 7.8% more than December 2009.

Due to their disproportionate buying power, spending by upper-income Americans is especially important. The top 10% of U.S. income earners take in 50% of the income in the U.S. and are responsible for 40% of discretionary spending. It's no wonder that producers and purveyors of luxury items (Macy's, Saks Fifth Avenue, Tiffany's and Coach) outperformed the S&P 500 total return index by double-digits in 2010.

Bloomberg's Retail Sales Comparison Index

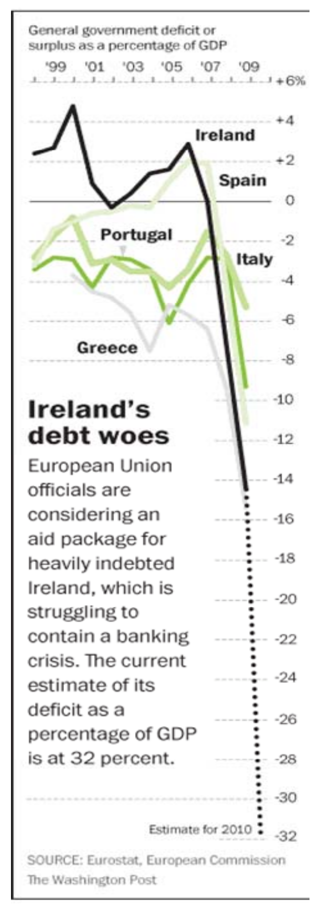


Bloomberg's Luxury Retail Sales Comparison Index



Celtic Tiger No More: Ireland Accepts EU-IMF Bailout

Between 1995 and 2007, Ireland had the whole world in the palm of its collective hand. During that timeframe, buildings were built at a torrid pace, real estate prices skyrocketed and the country's gross domestic product (GDP) grew 5%-10% per annum, ultimately exceeding the GDP of Great Britain. Today, Ireland must deal with 14% unemployment, home price declines of 36%, average family indebtedness of $175,500, debt-to-GDP approaching 100%, a budget deficit of greater than 30% of GDP (the U.S. is expected to be at a mere 10% in fiscal 2011) as well as three major failed banks that have needed $59.9 billion of government support. The situation deteriorated to the point that market participants issued a vote of "no confidence" by the end of November, as evidenced by yields on its ten-year government bonds that began approaching 10%. In the end, the Irish government had to accept a $113 billion bailout from the EU-IMF (note: the bailout equates to 30% of the country's annual GDP). Bloomberg Businessweek reports that "[farming] has become a respected profession again" as the unemployed head back into the fields.



State of the States

Meredith Whitney, a frequent contributor to CNBC, Fox Business and Bloomberg News, recently drew attention to the budgetary problems of America's state and local governments when she appeared on 60 Minutes in mid-December and predicted that 50 to 100 cities and/or towns could default in the near future. Her thesis: several sizable cities or towns will not be able to afford their debt payments as states and the Federal Government cut back on support. She went on to say that the buying opportunity will occur "when you see more defaults and indiscriminate selling…" Her warning rings true because California's fiscal trials have made the news numerous times as have Harrisburg, PA's issues; in fact Harrisburg openly contemplated bankruptcy. In addition, municipal bond yields recently spiked (yields move inversely to price), seemingly confirming the negative bias against debt issued by state and local government.

Still, certain observations and facts weigh against immediate sales of all municipal debt (or "hitting the bid" in industry terms). First, state and local tax revenues increased 5.2% in the third quarter of 2010 versus the third quarter of 2009. The higher revenues were the result of income tax receipts rising 4.8%, sales tax receipts moving higher by 4% and property taxes increasing 7.8% year-over-year. Second, recent yield increases for municipal bonds can just as easily be explained by the rush to issue Build America Bonds (BABs) before the program expired at year-end and/or a delayed response to higher Treasury yields (against which municipal bonds are normally compared). Third, some financial issues are case-specific. Harrisburg, PA, for instance, had been badly managed since the 1990s – it reportedly used debt proceeds to pay $125,000 for a gun once owned by Doc Holliday. And California's budget is a perennial problem, made worse by the state's specific governing structure. Finally, tens of thousands of state governments, local governments, and numerous other governmental entities issue debt, so the prospect of a couple of hundred defaults would be on par with historical precedent and is, therefore, not as alarming as it would seem on the surface.

Quantitative Easing Redux

On August 27, Ben Bernanke, Chairman of the Federal Reserve (Fed), spoke at the annual Jackson Hole, WY economic conference. His speech made it clear that the Fed would once again purchase U.S. government debt in size. Indeed, on November 3, the Fed announced that it would buy up to $600 billion of U.S. Treasurys in $75 billion increments over the next eight months. This action is regarded as the second round of quantitative easing and has been labeled QE2. Bernanke and the other Fed governors (save Thomas Hoenig, the Kansas City Fed president) opted for this course in order to stimulate the economy by bringing down longer-term interest rates. They also hoped to reset inflation expectations higher in order to avoid even the smallest possibility of deflation.

Those outside the Fed view QE2 in a different light. For instance, the Tea Party wing of the resurgent Congressional Republicans want Bernanke to "cease and desist," while other Republicans want to relieve the Fed of its dual mandate (stable prices and maximum employment). Still others simply desire to abolish the central bank altogether. The latter suggestion comes from Texas Representative Ron Paul, who will become chairman of the House subcommittee on monetary policy in 2011. Mr. Bernanke's appearances to Congress will likely be a bit livelier this year.

High-placed officials from foreign countries also object to QE2; they claim that the program is a blatant attempt at currency manipulation, or making the U.S. dollar cheaper in order to improve the country's competitive advantage. Brazil's finance minister, Guido Mantega, even put forth the idea that the world is engaged in a currency war. China's objection on this count may be the most ironic, since the country manufactures new Yuans to control its exchange rate with the U.S. dollar. Incidentally, China's actions are much closer to the "printing money" charge the Fed faces than the Fed's actions – at least the Fed ends up with taxpayer-backed U.S. Treasurys.

COMMENTARY: A Background on Gold Given Its Recent Popularity

Gold ownership is a relatively recent phenomena in the U.S. compared to the centuries' old tradition in many countries. Even so, we can trace our allure of the golden metal to the California Gold Rush which began on January 24, 1848 when gold was found by James W. Marshall at Sutter's Mill in Coloma, California. From that point forward, gold became an integral part of the economy of select Western states and eventually of the United States.

U.S. dollars were redeemable in gold until the 1930s, when most countries went off the gold standard for their currencies. When dollars were no longer backed by gold, gold ownership became illegal in the U.S. In 1944, the Bretton Woods Accord effectively made the U.S. dollar the main reserve currency of the world, whereby certain countries could redeem U.S. dollars for gold at $35 per ounce. With the inflation of the 1960s, many countries did just that, so in August 1971, President Nixon stopped the convertibility of the dollar into gold. Since then, the major currencies of the world are "fiat currencies," meaning they are backed only by the faith and trust of the government. In 1974, the gold market freed up as U.S. citizens were once again permitted to legally own gold. In 1975, gold futures began trading at the New York Commodity Exchange and the price of gold began to reflect "free-market" valuations. The price of gold subsequently rose to $800 per ounce in 1980 before trading in the $200-$400 range for 25 years. Gold prices then rose from $350 per ounce in 2005 to over $1,400 per ounce at the end of 2010, fueled in part by two stock market collapses within a decade, the bursting of the housing bubble, the near collapse of the financial system in 2008, and the sovereign debt problem of several European countries.

At $1,400 per ounce, all the gold in existence would be worth approximately $7 trillion. And, because of its density, all the gold that has ever been mined would not fill four Olympic-sized swimming pools. At the present price, gold production will undoubtedly increase, and while only 5% or so of all gold ever mined is traded in the financial markets, more of what is produced in the future will likely end up in vaults and lockboxes as investment. The U.S. government is the largest owner of gold (8,134 tons) followed by Germany (3,407 tons), the International Monetary Fund (2,967 tons), Italy (2,452 tons), and France (2,435 tons). On a per capita basis, Switzerland leads with 1,040 tons.

For the retail investor, owning gold as a commodity is difficult; it has to be safely stored, assayed, insured, and the trading is generally not cost effective. On the other hand, owning gold via exchange traded funds (ETFs) has become popular, as the costs are spread over many investors, and buying and selling is as simple as trading any other stock or bond.

Unlike financial investments, gold is difficult to value since it provides no cash flow. Its value is based upon what other people are willing to pay for it, and that is generally driven by fear and greed. When human behavior and emotions are allowed to influence investment pricing, rationality is not always present. While some argue accurately that the price of gold is actually below its inflation adjusted price of $2,350 ($800 in 1980) and opine that if the world goes back to a gold standard the ounce price will increase dramatically, others feel gold is the latest bubble and a dramatic decline is in order. Fear and greed only compound this juxtaposition.

Whether or not gold is in a bubble or in the midst of a longer-term rally is up for debate. Marc Faber, Nouriel Roubini, Louis Yamada all recently opined that gold will continue much higher this decade, albeit not without some severe price corrections along the way. Jason Schwarz, an option strategist and newsletter writer, on the other hand says "Gold at $1,400 an ounce is eerily similar to oil at $140." His view is similar to the view of many who are concerned about gold at these levels, especially with all the hype in jewelry selling, etc. Michael Lewis, commodity strategist at Deutsche Bank, warns that the formation of a gold bubble is a high probability event, although he thinks that would be at $2,000 per ounce. What is certain is that history shows us that investment strategies exist to help limit (not eliminate) risk exposure, the primary strategy being a well thought out and well executed plan for portfolio diversification between asset classes, sub-asset classes, sectors and industry groups. Such a strategy will not generally result in "immediate gratification", but will often result in gratification over meaningful investment time-frames.

The things that will destroy America are prosperity-at-any-price, peace-at-any-price, safety-first instead of duty-first, the love of soft living, and the get-rich-quick theory of life. ***– Theodore Roosevelt***

January, 2011