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Portfolio Insight

1st Quarter 2011

The US stock market had a solid performance in the first quarter of 2011, continuing the rally begun last August after the Federal Reserve indicated additional quantitative easing (QE2). The S&P 500 returned 5.9% and the Russell 1000 Growth index returned 6.0% through March 31. It is impressive that these returns were accomplished despite considerable political turmoil in the Middle East, which began with successful revolutions in Egypt and Tunisia and spread to other countries in the region.

This turmoil created concern about supply disruption of OPEC oil to the rest of the world, driving Brent oil prices up 24.3% during the quarter. The rise in the benchmark price of oil, combined with the continued rise in other commodities such as livestock, grains, and industrial and precious metals, has raised the volume of debate over QE2-induced inflation. Despite the large increases in the prices of these commodities and their impact on headline inflation, core inflation remains subdued. We believe core inflation will remain subdued for some time to come.

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In our last *Portfolio Insight*, entitled What Could Go Right?, we briefly discussed the weak US economy, our nation's deficits and debt levels, and our high joblessness. So far in 2011, it appears that slow but discernable progress is being made on these issues. Recent data releases point to improvement in employment. However, it is very early in the recovery game. Over the past forty years, as employment in our manufacturing sector declined we relied on financial services, the real estate industry, construction, and government to provide jobs. It will likely take many years to get back to what is considered full employment as these industries continue to contract.

On the government spending front, fiscal conservatives in Congress are working with the Obama administration to reduce the level of Federal spending for the remainder of the 2011 budget year. The deleveraging that is necessary and widely expected has begun among consumers, but not yet at the government level. It is not an easy road—nor will it be quick. But we think it is achievable. The greatest challenge is to reduce our debt to GDP ratio by growing our economy, without resorting to effective debt default through inflation.

Our investment focus at Chilton Capital Management is on those industries and companies that we believe will be able to thrive in the deleveraging environment we foresee, one that is faced by many countries around the world. Additionally, we want to invest in those companies in a unique position to help solve the problems we and the world face in such important industries as energy, agriculture, and health care. Our 2Q 2010 Portfolio Insight introduced our view that natural gas can be a major part of the long term solution to the US energy and balance-of-trade problems. As a result of the tragedy surrounding the nuclear plant in Japan, the case for natural gas has recently gained increased attention from Congress and the public.

The Case for Life Sciences

Perhaps the biggest problem for the US and, indeed, much of the world, is health care. The largest unfunded future liability in the US is health care costs through the benefits promised by Medicare, Medicaid, and corporate post-employment programs. Most in the US would find it unacceptable to withhold necessary health care related products and services. And relying heavily on mandated price cuts, as has been common for the past few years, leads to less innovation. It is often charged that drugs and medical devices are too expensive. In some cases, that is true. However, disease is more so. We think innovation is the cure.

An aging global population will require increased availability and spending on health care. The World Health Organization estimates by 2025, over 26 countries will have life expect-

ancies averaging over 80 years and that 1 in 10 people globally will be over 65 years of age. According to 2008 US Census Bureau statistics, the number of US citizens aged 65 and over will more than double by 2050 to over 80 million people, representing over 20% of the US population.

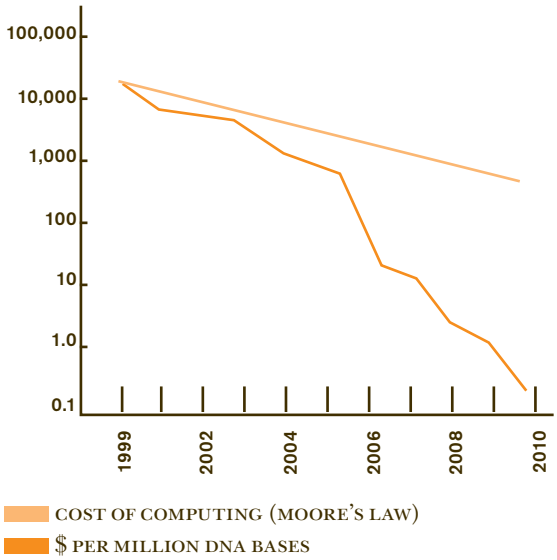
Global economic development and aging populations continue to drive demand for the life sciences industry. Increasingly, emerging markets are looking toward life sciences as an industry to increase internal production and export revenue. China, Singapore, and India are countries with high growth potential for life sciences with their educated workforces and attractive cost advantages. For example, the Chinese government sponsored $124 billion in health care stimulus for 2009-2011 in a pharmaceutical industry experiencing 20% annual growth for the past decade.

Technology Remains a Key: Better, Cheaper, Faster

The growth trajectory of life sciences in the 21st century may parallel the historical growth curve of information technology in the 20th century. As Moore's Law, which postulated that the number of transistors that can be placed on an integrated circuit doubles every 24 months, formed the basis for the rate of change in development of information technology, life sciences shares a similar basis, which is the exponential drop in time, resources and money required to sequence one human genome (over 3 billion DNA base pairs).

BASELINE INFORMATION

Cost of genome sequencing compared with Moore's Law for computers



Source: Broad Institute

What took 13 years and over $3 billion to sequence the first human genome in 2001 will soon take 3 days for less than $1,000, according to many experts. This substantial reduction in the time and cost to sequence the human genome will lead to a significant number of genomes sequenced and a corresponding increase in the amount of information available to develop technologies and therapies. This genomic sequencing data will build vast libraries of information from which to study the biologic basis of disease, offering discoveries into new disease pathways, new disease targets, biomarkers for diagnostics, and other technologies.

According to Dr. Eric Green, Director for the National Human Genome Research Institute at the National Institutes of Health, the current state of genetic research is in the second of five "chapters" leading to the full realization of the human genome for patient care. These five overlapping, but generally sequential chapters are guideposts for several decades of developments to come from genetic research and are paraphrased:

1. Decoding the human genome (technology largely completed)
2. Understanding the biology of the human genome (in process / current)
3. Understanding the biologic basis for disease
4. Developing therapeutics for the biologic basis for disease
5. Applying personalized medicine at the bedside

Technologies Reduce Time and Costs for Drug Development and Approval

Traditional drug development required a shotgun approach, enrolling thousands of patients into a drug trial in hopes of randomly helping enough patients to achieve appropriate efficacy that was statistically significant enough to get FDA approval. This shot-gun, non-targeted approach often led to failed drug trials. On average, FDA approval requires 10-15 years and over $1.3 billion. With only 1 in ~5,000 drug candidates getting FDA approval, this model has proven to be increasingly expensive and unsustainable.

Newer developments in life sciences tools and diagnostics along with information obtained from genetic research in biomarkers and molecular medicine has started to make an impact in targeted drug approval trials. These developments will allow drug companies to specifically identify and target patients, who, based upon their genetic and molecular make-up, will more likely than not respond to a drug.

By identifying appropriate profile patients, drug companies can enroll fewer patients (often in the hundreds) to achieve statistically significant results for drug approval. Because drug companies can and will be able to improve the patient pool in the design and execution of their trials, drugs can become FDA approved in significantly less time and at

dramatically reduced costs. The probability and number of drugs that can be approved will also increase, resulting in increased investment opportunities into these companies.

Mergers & Acquisitions Will Be Significant
Over the past decade, over 9,000 M&A deals, representing over $1.6 trillion, were consummated in health care. Pharmaceutical deals were close to half of the transactions, supported closely with deals in biotechnology, medical devices and health care services. For the first nine months of 2010, health care had 649 M&A deals representing $137 billion.

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Trends in life sciences M&A activity are expected to continue, mainly driven by more than $125 billion in expiring patents in the portfolios of large pharmaceutical companies, from now through 2018, and declining internal research and development budgets. For example, Pfizer recently announced a $2 billion reduction in its R&D budget for 2012. Large pharmaceutical and biotechnology companies are increasingly seeking to partner with or acquire smaller, more innovative companies to fill their product pipelines rather than relying mostly on developing new drugs through internal R&D. We believe attractive acquisition targets with approved or approvable drugs are investment opportunities within this M&A trend.

constitutionality, and while Congressional budgets have challenged the funding of reform, drug pricing pressures have had, and will continue to have, an effect on the sector. However, we believe that the pricing pressures on drugs will abate over time. Prescription drugs represent only about 10% of overall health care expenditures in the US and Canada; and, thus, only limited savings will be gained by pressuring drug prices.

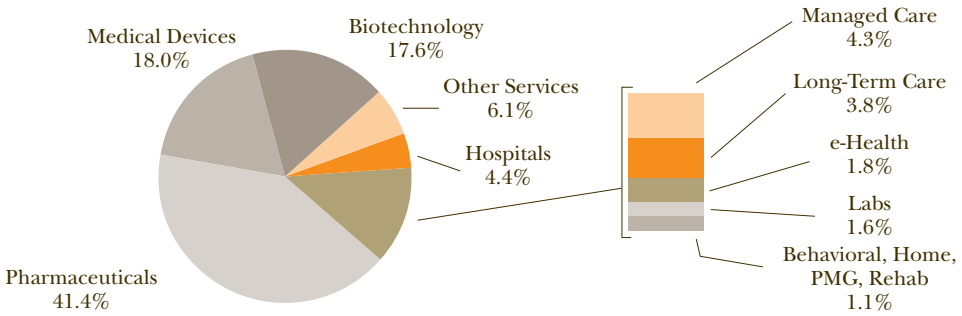
Many life sciences companies are less subject to these same pricing pressures because, as technology and innovation based companies, they are less exposed to the commodity portions of health care. The innovations occurring in drug development will likely result in lower drug prices along with more effective drugs. This, along with higher usage of generic drugs, should help alleviate societal pressures of growing health care costs.

Health Care is a Contrarian Investment Opportunity
Health care is currently a contrarian investment. The health care sector of the S&P 500 has been a laggard, annually returning 2.94%, -1.64%, and 1.88% over the past 1, 3, and 5 years, respectively. For the 10 years ended last year, the sector returned -0.23% annually.

During each of these periods, it has been the worst, or one of the worst, performing sector(s). Valuations and expectations for the life sciences sector are close to all-time lows.

Based on innovation, demographics, economic conditions, and valuations we think conditions

WHERE THE HEALTH CARE M&A DOLLARS WENT IN THE DECADE 2000-09



Source: Irving Levin Assoc., Inc.

Life Science in a Health Care Reform Environment
We expect the issue of health care reform will continue for some time. While many states have challenged health care reform's

are right for a secular improvement in performance for life sciences. Chilton portfolios hold a healthy dose of life science companies in pharmaceuticals, medical devices, and the tools needed for diagnostic tests and research.