

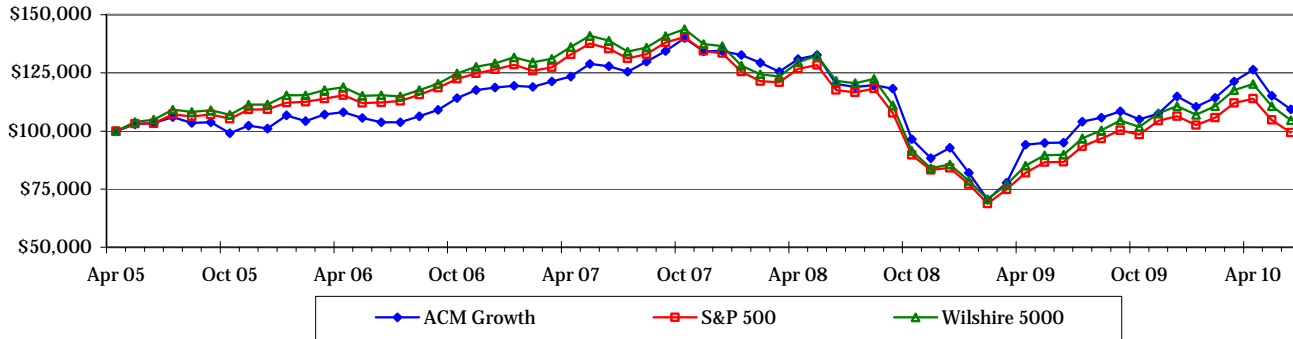


Athena Capital Management

Cumulative Growth Performance

Performance as of 6/30/10	Year to date	1 year	3 years	5 years	Since inception (4/30/05)
ACM Growth	-4.81%	15.13%	-14.47%	5.69%	9.35%
S&P 500	-6.65%	14.43%	-26.65%	-3.90%	-0.71%
Wilshire 5000	-5.48%	16.51%	-24.64%	-0.17%	4.67%

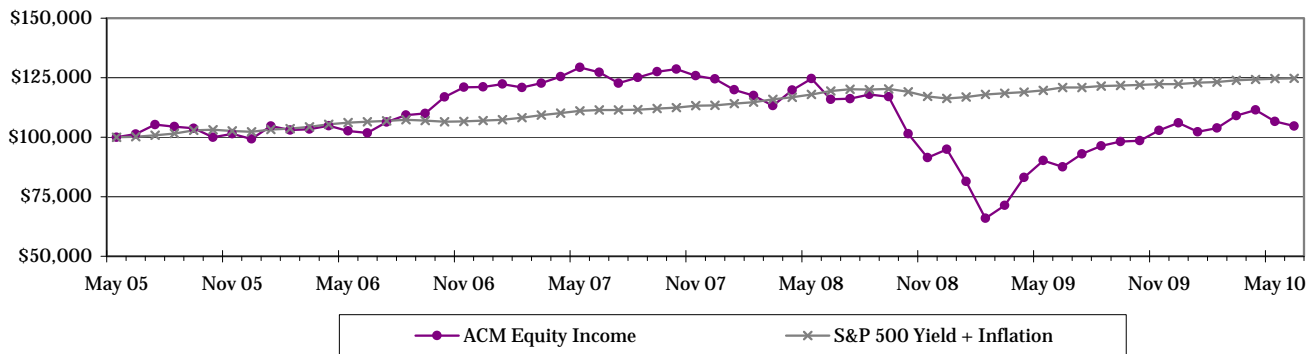
Comparison of the change in value of \$100,000 investment in ACM growth versus S&P 500 and Wilshire 5000



Cumulative Equity Income Performance

Performance as of 6/30/10	Year to date	1 year	3 years	5 years	Since inception (5/31/05)
ACM Equity Income	-1.14%	19.72%	-17.69%	3.39%	4.77%
S&P 500 yield + inflation	1.93%	3.13%	11.90%	24.46%	24.72%

Comparison of the change in value of \$100,000 investment in ACM equity income versus S&P 500 yield plus inflation



Past performance is no guarantee of future results. As in all equity investing, there is a risk for potential loss. Performance results were calculated after deduction of all management and trading fees. Portfolios were valued daily, trade date accounting was used, accrual accounting was used for dividends. Time-weighted rates of return that adjust for significant cash flows were used. Returns from cash were included. For ACM growth accounts, the S&P 500 was used as benchmark because it was deemed the most readily available and widely known growth composite. It should be noted that ACM growth accounts were more concentrated, sometimes had higher cash investments, included international investments, and were invested in companies with different market capitalizations and characteristics than the S&P 500. Although these differences existed, the accounts shown were invested for growth and not set to achieve any particular market capitalization or exposure. ACM equity income accounts used S&P 500 yield plus inflation because this combination of the most readily available equity yield and growth with inflation was deemed the most relevant benchmark for equity income accounts. These accounts are designed to provide an equity yield for income plus growth to maintain purchasing power over the impact of inflation. Both out- and under-performance of accounts shown were due both to individual security selection and to concentration of investments. Neither market nor economic conditions contributed significantly to account performance relative to benchmarks. ACM growth and equity income portfolios include all portfolios under management during all periods of management and include portfolio performance as of the first day of management. The accounts depicted used no leverage or derivatives. The S&P 500 and S&P 500 yield plus inflation returns shown do not reflect commissions, trading expenses, or management fees, which would have reduced both benchmarks' results.



Athena Capital Management

July 16, 2010

As I warned last quarter, storm clouds have been forming on the horizon. Markets woke up to these issues and declined over 11%. We were ready, primarily due to one security I'll discuss below, but weren't immune to the decline. Investment opportunities are cropping up all over, so I remain optimistic about our long term prospects.



In this quarter's letter, I'll discuss our performance; my view on markets and the economy; Greek Tragedy; and our investment in an unloved health insurance company: UnitedHealth Group.

Performance this quarter

Growth portfolios out-performed over all periods tracked (quarter, year to date, 1, 3 & 5 years, and since inception). After a strong April, markets sold off into May and June. We out-performed both because our securities did better than the market and because I decided to hedge against downside risk in late April. This hedge, discussed below (VIX futures), both allowed us to profit when the market declined and to buy at low prices. Opportunities like this don't come often, but can be handsomely profitable when they occur.

Growth's out-performance this quarter came from **S&P 500 VIX futures** and **Ryanair**.

S&P 500 VIX futures is an Exchange Traded Fund (ETF) that mirrors the volatility of the S&P 500 index. It goes up when stock prices fluctuate a lot, especially on the down side, and goes down when stock prices climb or are steady. I purchased it for our accounts because volatility seemed to be unusually low and as an insurance policy in case the market fell. It did, so we were able to lock in first 20% and then 57% gains. The security appreciated 48.5% during the quarter and we still hold a small position to protect against further market drops.

Ryanair is the Southwest Airlines of Europe—a no-frills discount airline providing flights at very low cost to customers. Investors seemed to be surprised that Ryanair managed to grow and generate profits despite Europe's economic downturn. This should be expected because low cost providers, like Wal-Mart, do well in tough economic times. I expect Ryanair to continue to grow profitably and to increase its low cost leadership versus competitors. We'll continue to profit if I'm right.

Dell and Sears were growth's under-performers this quarter.

Dell is the third largest manufacturer of personal computers and a growing provider of computer services. Although it reported excellent results in its most recent quarter, Wall Street continues to be concerned about market share losses and lower profit margins. Dell is intelligently adjusting its business model to generate sustainable profits instead of focusing only on short term margins and market share. This is the right thing to do for shareholders, but its efficacy will take time to prove out. In the meantime, Dell has over \$5 a share in cash and generated an 11.6% free cash flow yield over the last 12 months.

Sears Holdings owns Sears and Kmart stores in the U.S. and a majority of Sears Canada. Sears' stock price resembles a ping-pong ball—up one quarter and down the next. This quarter, its price was down due to a disappointing earnings report and bad news from the housing market. I continue to see these concerns as temporary, and have been eagerly increasing our position as its price goes down.

Equity income portfolios out-performed over the last year, but lagged our benchmark over all other periods (quarter, year to date, 3 & 5 years, and since inception). This reflects more the difficult benchmark I've chosen than any flaw in our portfolios. Our benchmark does not reflect changes in principal value, only yield and inflation, whereas our portfolio returns do reflect principal value changes. Over the long run our benchmark is a good comparison, but over shorter periods, like the last 5 years, mismatches are likely. The equity income portfolio yielded 3.9% at quarter end and is very likely to grow faster than inflation, thus providing a very satisfactory result for long term equity income investors.

Equity income out-performance this quarter came from **S&P 500 VIX futures** and **Winthrop Realty**. Please see above for my discussion of VIX futures.

Winthrop Realty is a Real Estate Investment Trust (REIT) that invests in down and out commercial real estate. Although it has and will suffer with the downturn in commercial real estate over the next few years, this is also the best time to invest in heavily discounted commercial properties. Winthrop is doing so and investors are taking notice: it returned 7.8% even as the market declined more than 11.4% (19.2% better than the market).

Equity income's under-performers were **Pfizer** and **Microsoft**.



Athena Capital Management

Pfizer is the world's largest pharmaceutical company. Despite on-going efforts to produce new blockbuster drugs, Pfizer has been reporting one research failure after another over the quarter. What the market is missing is that it is cutting costs just as quickly and still has a large stable of potentially marketable compounds. In the meantime, it pays a 5% dividend and is generating a 14% free cash flow yield.

Microsoft is the largest software producer in the world, but is facing increasing competition from market favorites like Apple and Google. Although such rivalry is undeniable, it has not yet dramatically eroded Microsoft's legacy businesses, which continue to be highly profitable. I think Microsoft's price reflects more concern than the facts merit, and its 2.3% dividend yield, 12.7% free cash flow yield, and likely 10%+ growth rate make it a relatively safe investment.

Market and economic outlook

The S&P 500 declined 11.4% this quarter, finally reflecting how far it had gotten ahead of fundamentals. At this lower level, I'm expecting not bad, but uninspiring, 6 year annualized returns of 6.85%. Higher returns are available elsewhere, just not from the market as a whole. That's why we're invested elsewhere.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	0.7% to 13.0%
S&P-500-yield-plus-inflation (equity income benchmark)	3.8% to 6.8%

How do I arrive at these numbers? Visit "Free Articles" at www.athenacapital.biz to see my 7/12/05 article.

After growing over 5% in the last quarter of 2009 and 3% in the first quarter of 2010, the economy is slowing notably. The \$64,000 question is whether this slowing will be the pause that refreshes—leading to higher growth—or another leg down into recession. U.S. factories are still humming, but unemployment claims remain high and the housing market looks to be hitting another speed bump.

High unemployment and declining stock and home prices do not make for a strong recovery. Added to this, most of the world's largest governments have gone from triple-A credits to looking more like sovereign subprime. There's little likelihood that these headwinds will disappear in the near or intermediate term.

Headwinds, however, do not make growth impossible. Railroad traffic in the U.S. has climbed since autumn 2008, indicating that the flow of goods within the U.S. continues. Commodity prices, too, have recovered from 2008 lows and remain at non-recession levels, predominantly due to emerging market demand. The headwinds of unemployment, housing and government debt have not decisively overcome both U.S. consumer and emerging market demand.

With headwinds and tailwinds in contention, neither strong growth nor deep recession is likely. However, slow growth—frequently referred to as the "New Normal"—is a likely scenario over the coming years. In such an environment, it's important to invest in strong businesses that can grow profits despite slower economic growth, and to look for unusual opportunities like buying volatility when it gets too low. In a range-bound market like this, flexibility is key. We're ready.

Greek Tragedy



Greece—birthplace of history, philosophy and much of western civilization—now most clearly illustrates its dramatic invention: Tragedy. Aristotle described it as drama where a hero suffers a reversal of fortune due to a mistake, arousing pity and fear in the audience. We may pity Greece's financial difficulties and riots in the streets, but not yet fully grasp the fear—that Greek Tragedy will play on stages more consequential and closer to home.

Greece is in financial trouble because it borrowed beyond its means. Like subprime borrowers buying large screen TV's, Greece knew it couldn't *really* repay its loans. Like subprime banks lending to poor credits, European banks *hoped* the loans would default on someone else's watch. A brief analysis of debt to gross domestic product or government spending to tax revenues reveals our hero's mistake. A reversal of fortune was inevitable.

Historically, countries in this situation have "solved" their problem by paying back loans with printed rather than earned money.





Athena Capital Management

But, Greece can't do this because it joined the European Union and adopted its currency, the euro. Greece can't print euros, and the countries powerful enough to allow such printing—Germany and France—are loath to take this route.

Greece's problems would be its own—and we'd only feel pity—if it weren't for the fact that much of Europe made the same mistake. Greece, by itself, is a small and inconsequential part of Europe's economy. But, when combined with Portugal, Ireland, Italy and Spain, adds to a mighty sum. If a few of these countries default, the big banks of Europe—based in Germany, France and Britain—will likely need bailouts. These combined factors could hurt Europe's economy greatly. Now, the fear parts comes in, because Europe's economy—as a whole—is the largest in the world (larger than U.S., Chinese or Japanese economies). Could this lead to another recession? Could the European Union fall apart? Would that impact us in the short and long term? Tragedy indeed.

Unfortunately, Greek tragedy is not solely a drama in Europe. **Acts 2, 3 and 4 are likely to play out in Japan, Britain and the U.S., because each has borrowed heavily to provide benefits beyond its means.** Unlike Greece, each has its own currency and can thus "solve" their problem with inflation. However, California, New York and Illinois—the Spain, Italy and Greece of the U.S.—can not print currency. Just like Germany and France bailing out Greece, the U.S. may very well find itself bailing out wayward states. Just like Germany and France, we may learn that inflation is a "solution" with very unpleasant side effects. And, like Germany and France, we may find our fiscal problems much larger after additional bailouts. Simply tragic.



All hope is not yet lost—solutions exist. We could cut spending and benefits, promote growth, and restructure our debt. But, I fear such austerity measures will prove as unpopular in Illinois as they've proved in the rioting streets of Greece. Our hero can change the story from Greek tragedy to triumphant drama, but it will require some hard medicine. It will be interesting to see if we take small doses now, or unpleasantly large doses later...

Investment Spotlight: UnitedHealth Group

Some of the best investments are unexciting at first glance, and you can't get much less exciting

than healthcare insurance. I won't sport with your intelligence by trying to jazz it up too much, but you may discover some interesting points. For instance, did you know the modern U.S. health insurance industry is less than 40 years old and was generated by government mandate? Did you know less than half of UnitedHealth's business doesn't bear the risk of medical costs? Did you know UnitedHealth's fastest growing businesses aren't insurance? If you're already asleep, this review may seem dull. But the potential returns from UnitedHealth might perk you up a bit, and that's exciting all by itself.



Health insurance first grew out of the disability insurance industry in the late 1800's—people injured on the job needed medical care. The two separated in the 1920's when a teacher's group formed the first pooled health insurance in Texas. Employers got involved during World War II, when wage controls limited pay. As soon as the government ruled that medical expenses weren't pay, employers raced to offer medical care as an employee benefit. Medical insurance finally become standard with the Health Maintenance Organization Act (HMO) of 1973, which mandated employers of more than 25 people offer a federally certified HMO option. That's when the health insurance industry we know today truly took form.

UnitedHealth came in to being in 1974, only a year after the 1973 Act. It now provides both healthcare Benefits and Services. On the Benefits side, UnitedHealth offers health insurance for individuals, small and medium businesses, large multi-state businesses, specialized healthcare for those over 50, and Medicaid and Child Health Insurance programs. Benefits include both risk-based (where the insurer bears cost risks) and fee-based (where the employer bears the risk) options. **Interestingly, less than half of UnitedHealth's Benefits are risk-based, making its business more stable and less risky.**

UnitedHealth's Services businesses provide: 1) information technology—software and data—for pharmaceuticals, health insurers, doctors, hospitals, employers, and governments; 2) specialty services—like mental health—and banking services—like Health Saving Accounts; and 3) pharmacy benefits management—complex purchasing and distribution of pharmaceutical products.



As you can see, UnitedHealth is more than



Athena Capital Management

just a health insurer. In fact, last year it served 75.2 million while providing health insurance to only 32.3 million. Certainly, Benefits are the largest portion of UnitedHealth's business (78% of revenues, 83% of profits), but Services are growing much faster—14.5% versus 4.7%. In the future, services will be UnitedHealth's growth and profit driver because it's the business most likely to reduce medical care's costs and to benefit from new regulatory pressures.

Like all our investments, UnitedHealth is a good news bad news story—that's why it's cheap! **The good news: low capital expenses and high barriers to competitors.** Health insurers don't need to build factories, buy expensive inventory, or sink lots of money into costly research and development. This means profits go to shareholders instead of merely maintaining the business. In addition, the health insurance industry is protected by a regulatory framework that requires scale. Extensive regulation, at both the state and national level, make it very difficult to enter the industry. Plus, large size allows bargaining power with doctors, hospitals, employers and employees. If you want to offer medical care on a national level, you need to be large. UnitedHealth is.



The bad news side of the story includes regulatory change, high unemployment and the difficulty of pricing premiums and benefits. Health care regulation will impact UnitedHealth, but it's not clear how. On one hand, they'll have to cover pre-existing conditions; but, on the other hand, they'll have a new pool of healthy customers paying premiums because health insurance will become mandatory. Higher unemployment is bad because it means fewer customers and premiums for UnitedHealth, and because most insurance is attained through employers. When employment does pick up, it will become a tailwind instead of a headwind. Pricing medical benefits, even one year in advance, is difficult to do precisely—a heavy flu season dramatically raises costs. Because sickness (like swine flu) comes and goes in waves, cost variability tends to go in cycles, too. We're entering a better period after a multi-year negative cycle, which should be good for UnitedHealth.

Does the good outweigh the bad? As usual, it depends on what you have to pay—and UnitedHealth looks cheap. Our purchase price provides a 12% free cash flow yield using a three year average (15% using the last 12 months). Assuming UnitedHealth can keep up with the economy's 6%

growth (by no means assured) it provides an 18% return. Granted, UnitedHealth might become less profitable, grow slower, or lose business. But, it might also grow by becoming more efficient, expanding its services businesses, and beating its competition. There are threats, to be sure, and its price reflects them. Its price does not, however, reflect underlying free cash flows or the possibility that a few threats might not be fully realized. Good odds for us.

Until next quarter

Great clients are necessary for great results. If clients panic at the bottom or become euphoric at the top, an investment manager is hamstrung. When clients stay the course or contribute capital at the bottom and become conservative at the top, great results are possible. With great clients like you, I believe great results are in the bag.

But, great results take time. Markets move in unpredictable ways that make even five year records a poor indicator of long term results. I wish I had a crystal ball that perfectly predicted when to get into and out of the market; I don't, and neither does anyone else. Thank you for your patience; I believe it will pay off in time.

If you know someone in need of financial advice or services, please put them in contact with me. I continue to seek investors like you and would be happy to help anyone you send my way. Let me know if you find someone interested.

My blog, www.mikerivers.blogspot.com, continues to generate interest from clients and non-clients alike. In it, I provide timely insight into markets, the economy, investments and financial planning. Please visit and sign up to receive it by email if you get a chance.

If you ever have questions or comments for me, please contact me at your convenience. It's always great to hear from you.

Respectfully yours,
Mike

Michael Rivers, CFA
Athena Capital Management
370 Waco Court, Colorado Springs, CO 80919
719-761-3148, mike@athenacapital.biz