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BRIDGEPORT
ASSET MANAGEMENT INC.

Q3 2010
Investment Commentary

Major stock market indexes continued to advance in the third quarter despite ongoing macroeconomic concerns. The S&P 500 and TSX Composite rose 10.7% and 9.5%, respectively, in Q3 2010.

Notwithstanding the recent market recovery, the stock market correction of 2007-2008 has caused a general shift in investor sentiment away from risky assets. This flight to safety has led investors to embrace such previously neglected assets as bonds and gold.

Investors have increased their exposure to bonds relative to equities in search of more stable returns. This shift is understandable as many investors were previously overexposed to equities given their risk tolerance and time horizon, although they unfortunately came to this realization late in the game as a result of the stock market correction.

Our perspective at Bridgeport is that some segments of the corporate bond market remain attractive, although others appear to be overbought. In particular, investment grade corporate bonds with maturities of more than five or six years should be avoided as they currently offer investors unattractive risk-adjusted returns. It is difficult to make a case for investing in a ten year investment grade corporate bond with an annual yield in the 4% range. Surely other investment opportunities will offer better risk adjusted rates of return over that time period, especially when inflation returns and interest rates inevitably return to more normal levels.

We are more positive on corporate bonds with shorter to medium term maturities (i.e. three to six years). Investment grade bonds in this category still offer modest returns but will be less sensitive to increasing interest rates. Similarly, we see attractive opportunities to purchase higher yielding bonds issued by medium sized companies with lower than investment grade credit ratings. We believe these bonds offer investors reasonable protection and better rates of returns even in a modestly rising interest rate environment.

Our view on gold is more negative. Despite the shiny metal’s current status as the investment of choice, we view it as an inherently volatile asset which offers investors little in the way of protection. Gold arguably has a higher risk profile than equities as the price of gold is tied to investor sentiment which can change rapidly. Because the existing inventory of gold is never depleted (unlike oil) and it produces no cash flow against which its price can be assessed, gold is susceptible to significant price swings. For example, after peaking at $678 per ounce in January 1980, the price of gold dropped 43% over the following two years.

Gold has also been on one of the worst performing asset classes over the long term. After adjusting for inflation, the price of gold has essentially remained unchanged over the last 200 years.

We have little to offer to the debate as to whether the price of gold will continue to increase as it is basically a guessing game. Given gold’s investment attributes however, we believe anything more than a minimal portfolio allocation to gold is imprudent.

We prefer to manage risk by making investments in companies which produce consistent and relatively stable profit and cash flow. To this end, we added several stocks to Bridgeport's equity portfolios in the third quarter including the common shares of Mac-Gray Corporation.

Founded in 1927, Mac-Gray operates debit-card and coin-operated laundry facilities in multi-unit housing facilities including apartment buildings, college and university residence halls and condominiums. The company manages approximately 88,000 laundry rooms in 43 states under long term customer contracts generally ranging from seven to ten years in length.

Mac-Gray's revenue and cash flow are particularly stable given the large size of its customer base, the contractual nature of its client relationships and the fact that high multi-unit residential occupancy rates ensure that a steady flow of tenants use Mac-Gray's laundry facilities.

We invested in Mac-Gray based on the company's ability to use its strong annual cash flow to pay down debt. We believe that we should be able to earn a 20% annual rate of return on our investment in Mac-Gray even if the company does not grow in the next few years.

We expect to achieve this level of return based on our purchase price of $10.85 per share which equates to a value for 100% of the shares of Mac-Gray of approximately $150 million. Our analysis also suggests that the company generates approximately $30 million of annual cash flow (after interest, maintenance capital expenditures and taxes) which can be applied to pay down Mac-Gray's net debt of $225 million.

The total value of Mac-Gray is $375 million (i.e. $150 million of equity plus $225 million of debt). For every dollar of debt which the company repays, the value of its equity increases by the same amount. This is similar to buying a house with some money down (equity) and the balance paid for with a mortgage. Assuming the value of the house does not change over time, the value of the homeowner's equity in the house increases dollar-for-dollar as the principal balance of the mortgage is reduced.

In the case of our investment in Mac Gray, its equity value of $150 million will increase by $30 million annually assuming the total value of the company remains at $375 million and the company is able to generate enough cash flow to reduce its net debt by $30 million per year. An increase in equity value from $150 million to $180 million (or $10.85/share to $13/share) equates a 20% annual increase in value. Based on these economics and the company's stable business model, we believe this is a reasonable risk-adjusted rate of return on our investment.

In terms of dispositions, we elected to sell all our shares in Pizza Pizza Royalty Income Trust in both Bridgeport's Equity and High Income Portfolios early in the quarter. Based on its 14% dividend yield, we earned an attractive rate of return on our investment in Pizza Pizza during our hold period, although we had become increasing concerned about the safety of the company's distribution given continued same store sales declines and deteriorating cash flow.

In general, we are optimistic about the stock market over the long term. Nevertheless, the short term direction of the market is impossible to predict and there always exists a possibility of a modest correction especially given the recent market run-up.

We would like to take this opportunity to wish you all the best for the upcoming holiday season. We encourage you to call should you have any questions.

Yours truly,

John Fisher, CPA, CFA