

INVESTOR EXPRESS

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Strategic Options Trading Generates Profits

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Since we expanded the information on our options transactions in the Adams Express (ADX) and Petroleum & Resources (PEO) financial reports over the past two years, we have received questions from our shareholders: What is management's experience in trading options? How do options contribute to profitability? Is options trading a speculative activity that is contrary to management's conservative approach toward investing? Here, we address those issues.

The primary goal of our options program is to generate income from the premiums received. An option that gives the right to buy the stock is a *call* option; one that gives the right to sell is a *put* option. We typically write the option contract, and if the option expires without being exercised, we keep the cash premium that was paid to us by the option contract's holder.

The conservative use of options has been integral to our trading activity for more than 25 years. Over the past decade, we have averaged annual profits of \$2.3 million for ADX and more than \$600,000 for PEO. These profits make significant contributions toward offsetting the Companies' expenses.

"Our approach to options transactions is conservative and is totally integrated into our investment program," says ADX President Joseph M. Truta, the portfolio manager responsible for the options program.

"We write calls on stocks that we are willing to sell at prices above the current market price of the underlying security," he says. Either the option contract expires as worthless, generating income from the premiums received, or the stock is sold at a profit, thereby generating capital gain on the portfolio security. "Our approach is designed as a win-win proposition," he says. The options program also aids the companies' selling discipline in that we continually assess our target prices and use the options market to effect some trimming of positions.

Our primary strategy is to write "out of the money" options; that is, call options for which the strike price is about 10% above the market or put options priced 10% below the market. The Companies' call transactions are "covered" because we have the shares in our portfolio. Covered calls are considered the least risky form of options trading.

"We only write options on securities that are already in the portfolio, and then on only about 10%–15% of the shares owned in that security," Mr. Truta says. "In the case of put options, we only enter into transactions on securities that we would want to own at prices below the current market price."

Because of this emphasis on out-of-the-money options, only 13% of options contracts in 2004 were actually exercised in ADX; 22% were exercised in PEO. The premiums we

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The terminology used in options transactions is unique and can be confusing. We hope this glossary will be useful.

Call: An option that gives the right to buy a contract on an underlying interest.

Expiration date: The date a contract for the option ceases to exist. At that point, the owner of the option who does not exercise the contract has no "right" and the seller has no "obligation" as previously conveyed by the contract.

Option: The right to buy or sell a specified amount or value of a particular underlying interest at a fixed price before a contractual expiration date.

Option holder: The person or entity buying the right conveyed by the option.

Option writer: The person or entity selling the right conveyed by the option. (This is the usual practice of the Companies.)

Out of the money: If the exercise price of a call is above the current market value of the underlying interest, or if the exercise price of a put is below the current market value of the underlying interest, the option is out of the money by that amount.

Premium: The price the option holder pays and the option writer receives for the right conveyed by the option.

Put: An option that gives the right to sell a contract on an underlying interest.

Strike price: The contractual price at which a call or put option of the underlying interest will be purchased or sold in the event the option is exercised.



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Meet the Assistant Treasurer



CHRISTY SLOAN
Assistant Treasurer

Christy Sloan's job as Assistant Treasurer continues to evolve six years after she joined the Companies. "New accounting and compliance requirements continue to change how we report to shareholders," she says. "If the new methods make our internal controls stronger or our reports easier to understand, it's all worthwhile."

Christy supervises the accounting staff, prepares financial reports, assists in the budgeting process, and oversees the payrolls. In addition, she manages the Companies' cash positions and administers the Companies' retirement plans.

"I am always looking for ways to improve the Accounting Department's efficiencies and cost effectiveness by automating our processes and streamlining operations," she says. "At the same time, maintaining strong internal controls is always a priority," she adds.

A certified public accountant, Christy came to the Companies from PricewaterhouseCoopers' Baltimore office where she was a manager in the financial services group. She graduated from the University of Delaware with an accounting degree and recently received an MBA from Johns Hopkins University.

Outside of work, Christy and her husband, Mike, focus their time on their family, which grew exponentially upon the birth of their twins, William and Molly, eighteen months ago.

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received for the contracts that expired in 2004 generated profits exceeding \$1.4 million for ADX and more than \$500,000 for PEO.

Trading in options has been profitable for us in all kinds of market conditions. "Our strategic objective is to achieve balance in our options program by writing both calls and puts for income,

although we would tend to write more calls in a rising market, and write more puts in a declining market," Mr. Truta says. In 2004, PEO wrote more call options than puts in conjunction with the strong energy market, and ADX wrote more puts than calls, given the reduced overall market volatility as measured by the S&P 500 Index.

Market View

Predicted '05 Influences Become Reality

This column is an update on some of the economic and market factors discussed in the letters to shareholders in the Companies' 2004 annual reports.

Crude oil. The price of crude is an important influence on our portfolios, most obviously in the case of PEO because of its holdings in major petroleum retailers, producers, and distributors whose profits and stock prices tend to rise along with oil prices. ADX also is a major shareholder of PEO and other energy stocks.

The predicted continued rise in the price of crude oil has occurred. In March, the price per barrel for April delivery was trading in the mid-\$50s; it was a few cents higher for May delivery. The price trend reflected by longer-dated futures appeared to be firming more for the long haul than for a mere spike.

Sustained high energy prices would cut into the profits of transportation, manufacturing, and power generation companies as higher fuel prices kick in. Consumers can expect to pay more for gasoline and utilities.

Interest rates and economic policy. The gradual rise in short-term interest rates that began in the second half of 2004 has continued, as predicted. The markets seem to be accommodating Fed increases as indicative of economic health, so stock prices have not shown dramatic volatility. Of concern has been the narrower gap between the Fed's short-term interest rates and the long-term rates set by the market. Long-term rates have not had a commensurate rise to keep pace with short-term rates. To some, this indicates a lack of confidence

in future U.S. economic growth, perhaps due to the weaker dollar or the growing federal deficit.

Stronger and weaker market sectors. We had forecast growth in the energy, utility, and telecommunications sectors for 2005. In March, Dow Jones reported compilations of funds that included natural resources up more than 15%, utilities holding their own at +2.78%, and telecommunications up 1.16% in February but down 3.66% for the year to date. Natural resources and utilities are the only sectors showing positive performance so far this year.

Our forecast for weaker performance in 2005 for the technology and health care sectors is accurate so far, with Dow Jones reporting -3.66% for the science and technology sector and -4.28% for the health and biotechnology sector.

Lower risk stocks. The current economic cycle and market volatility have led us to emphasize lower risk, dividend-paying stocks to help our portfolios perform better than the market. Examples include the fourth-quarter addition of shares in Pfizer, Unilever, and North Fork Bancorporation.

This early in the year, we are not making wholesale portfolio changes to reflect the short-term outlook. As long-term investors, we are investing in companies with long-term prospects that are not reflected in the current stock price. Thus, although 2005 might not be a great year for Pfizer, the longer term outlook is excellent, and the stock is cheap.

We look forward to receiving any questions or comments from our shareholders.

This newsletter is sent to the stockholders of The Adams Express Company and Petroleum & Resources Corporation for their information. It is not a prospectus, circular, or representation intended for use in the purchase or sale of shares of the Companies or of any securities mentioned in the newsletter. Past performance is not indicative of future investment results. The rates of return will vary and the principal value of an investment will fluctuate. Shares, if sold, may be worth more or less than their original cost.

Forward-Looking Statements

This newsletter contains "forward-looking statements" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934. By their very nature, all forward-looking statements involve risks and uncertainties, and actual results could differ materially from those contemplated by the forward-looking statements. Several factors that could materially affect the Companies' actual results are the performance of the portfolio of stocks held by the Companies, the conditions in the U.S. and international financial markets, the price at which shares of the Companies will trade in the public markets, and other factors discussed in the Companies' periodic filings with the Securities and Exchange Commission. The Companies assume no obligation to revise, correct, or update these statements.