

## MARKET UPDATE FOR OUR CLIENTS

We continue to be faced with an extraordinarily difficult economic and market environment, one that has tested the confidence and patience of many investors. We wanted to share with you our current investment positioning, some perspective and analysis on the overall investment environment, as well as some important information on the safety of your assets.

### Current Investment Positioning & Strategy Outlook

Our primary job as investment managers is to allocate capital in a way that will meet our clients' investment objectives in the long run, whether they be *growth*, *balanced*, or *income*. This has been the most challenging period in recent memory for making capital allocation decisions. Cash and cash equivalents have been the only true safe-haven assets, and we have generally held above average investment reserve positions. With the benefit of hindsight, we wish we had held more. Our decision to hold above average reserves (both in client portfolios and the two mutual funds that we manage) has generally helped us materially outperform client objectives had they been fully-invested. While these reserves have helped relative performance, ***we do not believe that now is the time to raise significantly more cash.***

Going to cash may provide certainty amidst a great deal of fear and uncertainty, but it also locks in portfolio losses and provides very low rates of return over time. As we write this letter, the major market indices have reached new lows, so the cash that we have raised over the last year has been raised, for the most part, at significantly higher prices. Our intention is to re-deploy this cash slowly, prudently and, most importantly, at lower prices than we initially sold.

It is also important to note that our ***investment style is not entirely market dependent.*** For example, in December of last year, we made an allocation to inflation protected bonds for most accounts across objectives. Additionally, our last letter discussed our current focus on moving "up the capital structure" from stocks to investment grade corporate bonds. While we have so far provided only minor exposure here, we continue to seek opportunities in attractively priced bonds. Indeed, the current economic weakness appears to have provided great long-term buying opportunities in many diversifying asset classes such as real-estate, commodities, and possibly gold. Because short-term uncertainty remains at elevated levels, we intend to redeploy cash slowly, perhaps only buying in small 1% increments.

### Current Investment Environment

Many are comparing this period to the "Great Depression". While we can debate at length over the merits of this comparison, it is apparent to all that we are undergoing a severe economic recession that is global in nature. By 1933, at the very depth of the great depression, the Dow Jones Industrial Average had declined approximately 89% from its 1929 high. As of the writing of this letter, the DJIA is down approximately 53% from its October, 2007 highs. ***From the depression lows of 1933, however, stocks recovered and had returned more than 400% by 1937.*** Our goals during severe downturns are to avoid a portion of the downside while not violating client investment objectives and to opportunistically reinvest investment reserves at lower prices. By doing this, we will participate in the eventual recovery of financial markets and provide our clients with meaningful long-term rates of return, within their investment objectives.

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## Safety of Your Assets at Charles Schwab and TD Ameritrade

Over the last several months we have had questions from clients regarding the safety and security of their investment accounts. We custody our client assets at Charles Schwab and Co., Inc and TD Ameritrade, Inc. Based on audited financial statements and disclosures, both institutions are financially sound and neither has received “bailout” money from the federal government. We are especially proud that neither of our custodians were affected by the sub-prime and other mortgage related problems that have severely hurt many of the world’s largest financial institutions.

In addition to the strong financial position of these firms, there is additional SIPC (Securities Investor Protection Corporation) protection of up to \$500,000 per client account. Each firm has also purchased excess SIPC insurance sufficient to further protect client assets. Finally, unlike deposits at a bank which are effectively loans, your assets are simply held in custody and are segregated from any potential liabilities of the custodian. Please contact us if you would like more in depth information regarding these asset protection measures.

### Conclusion

It may seem impossible to imagine an economic and market recovery from here. Like the seasons, the environment that we are in will change. By definition, investors are most pessimistic at a market bottom. There is a huge amount of cash on the sidelines, which is generally a good sign that we are at or near a market bottom. When everyone is extremely pessimistic there are few investors left to sell. Then, as bargain hunters start to step in, a powerful rally can develop. We remain confident that when we look back on this period 3 to 5 years from now, it may be viewed as one of the investment opportunities of a lifetime.

If you are not sure if you can withstand more volatility, we urge you to contact us immediately so that we can adjust your investment mix to a fully conservative posture. Since client risk levels vary according to investment objectives, it is important in an environment as volatile and trying as this one that you are comfortable with your portfolio asset mix.

As always, we greatly value the trust and confidence you place in us to manage your investments and look forward to more prosperous times ahead.

### *Your Portfolio Management Team*

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