INVESTMENT STRATEGY UPDATE

September 17, 2008

Showdown

The volatility we've seen in both the equity and fixed income markets this week is a result of what can best be described as a combination of overly aggressive short selling, investor panic, and a battle of wills between representatives of the U.S. government and the private financial services industry. The financial crisis that began more than a year ago continues to unfold, and Ben Bernanke, Chairman of the Federal Reserve and Henry Paulson, Secretary of the Treasury are trying to draw their line in the sand. They fulfilled their moral obligation to rescue Fannie Mae and Freddie Mac, but were very reluctant to commit further taxpayer dollars to support private enterprises such as Lehman Brothers. The takeover of AIG, however, is a different story. The authorities had no choice, as the counterparty interests were just too intertwined and would surely have resulted in a cascade of further difficulties.

Nonetheless, we believe that the newfound government discipline is a good thing, because it sends the clear message that there is no longer an automatic safety net for companies that engage in risky behavior. Unfortunately, it also means that we are mired not only in a general credit contraction, but also in a severe liquidity crisis. We are hopeful that this latest bailout will soon calm the financial markets and bring at least some temporary stability, while the overall financial leverage continues to be unwound. We are also hopeful that the SEC will step in to curb the enormous speculative hedge fund short selling.

In the midst of the market turmoil we're experiencing we must remember a few basic, but meaningful facts. This is not the first financial crisis our country has experienced. We need only look back to the period 1986-1995, when nearly half of all savings & loans went out of business. Clearly, the system survived. Furthermore, our economy, though struggling, is in better shape than some around the world. In fact, the U.S. stock market is down considerably less than many European and Asian markets. Despite all the weakness in housing and consumer spending, the economy has actually continued to grow. While recession seems more likely now, strong exports resulting from a weak dollar should continue to offset domestic weakness. Furthermore, energy prices, while still quite high by historical standards, are moving lower, which will ultimately serve to shore up consumer confidence as well as lead to a declining inflation number.

Our portfolios remain diversified and focused on companies that are well-managed, with sound financial statements, desirable products, strong end markets and reasonable valuations. We are confident that a year or so from now, we will look back at this period and be happy we stayed the course.

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