February 2008

Dear Client,

Enclosed are the 2007 returns for your account(s). Where applicable, three and five year returns are included as well.

The S&P 500 returned 5.5% with dividends for 2007. Our account composite returned 4.0% for the year (individual account results may vary). Since inception on 01/01/00 and through 12/31/07, the overall return of the composite has been +95.85% vs. +14.05% for the S&P 500 with dividends. On an annual basis, that works out to 8.77% vs. 1.66% respectively. As noted in last year's letter and worth noting again, we make no effort to mimic the short term performance of the S&P 500 index. Over the longer term, it is a valid benchmark for assessing the performance and returns of U.S. industry.

Last year was the beginning of the great unraveling of the housing bubble. It is now in full swing as housing inventories swell and mortgage lending standards tighten. A negative savings rate, combined with an inability of consumers to finance consumption through home equity extraction is now impacting retail sales.

Against this backdrop are the large losses and increases in loss reserves by commercial and investment banks and their concomitant capital-raising efforts. Credit, which as recently as early 2007 was available to anyone with a functioning respiratory system, is now limited to those with good credit histories and a down payment. In short, those likely to repay a loan.

The seizure in the credit markets has inevitably spilled into the equity markets. Through mid February of 2008, the S&P 500 was down approximately eight percent. Treasury yields have collapsed and the spreads on lower rated bonds have widened markedly. The "R" word - recession- is now mentioned frequently by various market prognosticators and politicians. From an investment standpoint, fear has replaced greed as the overriding sentiment.

This type of an environment- where fear has replaced greed- suits us perfectly. Generally speaking, we are buyers of businesses. When fractional pieces of those businesses- stocks- become mis-priced due to overly negative sentiment, long-term bargains can often be found. Volatility and wild swings in the stock market are not the enemy of the investor, but a friend (for those who may be unfamiliar with this concept, enclosed is a copy of Benjamin Graham's famous "Mr. Market" allegory). This point can not be over-emphasized; with respect to short term price swings, often there is no relationship between a company's share price and its business value. Business value will ultimately be determined by the cash flow generating ability of a company and not by news headlines.

Whether or not current conditions are ultimately regarded as a recession will only be known in hindsight. We don't know and don't care. We won't be able to call an end to any recession just like we can't identify an exact bottom in individual stock prices. What we do know is that there are many attractively priced securities with very good return potential. It's no accident that most of our managed accounts have ample cash positions and can take advantage of recent price declines. We are ready, able and have a large list of pre-identified securities we're interested in purchasing at the right prices.

Please feel free to contact us with any questions or comments. As always, thank you for your trust and patience.

Very truly yours,

Eckart A. Weeck
Managing Director

Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.

Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behavior, the better for you.

But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to either ignore him or to take advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "If you've been in the game 30 minutes and you don't know who the patsy is, you're the patsy."

Ben's Mr. Market allegory may seem out-of-date in today's investment world, in which most professionals and academicians talk of efficient markets, dynamic hedging and betas. Their interest in such matters is understandable, since techniques shrouded in mystery clearly have value to the purveyor of investment advice. After all, what witch doctor has ever achieved fame and fortune by simply advising "Take two aspirins"?

The value of market esoterica to the consumer of investment advice is a different story. In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks and markets. Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind.

Following Ben's teachings, Charlie and I let our marketable equities tell us by their operating results - not by their daily, or even yearly, price quotations - whether our investments are successful. The market may ignore business success for a while, but eventually will confirm it. As Ben said: "In the short run, the market is a voting machine but in the long run it is a weighing machine." The speed at which a business's success is recognized, furthermore, is not that important as long as the company's intrinsic value is increasing at a satisfactory rate. In fact, delayed recognition can be an advantage: It may give us the chance to buy more of a good thing at a bargain price.*

* From the Berkshire Hathaway 1987 Annual Report