November 3, 2008

Dear Highlander Capital Management, LLC Client,

News coverage over the state of the financial markets has once again become a fixture of daily life. What had been a relatively orderly unwinding of the credit bubble turned into a full-fledged seizure and rout of the financial markets in October. Wild price swings in panic and near panic conditions characterized many of the trading sessions. As prices for almost all asset classes began declining, many leveraged funds were forced to liquidate their holdings; out went stocks, bonds, bank loans, futures contracts and commodity positions. As the declines began to accelerate, mutual fund companies began to experience redemptions from retail investors and thus were forced to sell as well. By the end of the month, the S&P 500 was down almost 17% bringing the year-to-date performance for this broad stock index to minus 34%.

In light of these circumstances, some clients may have questions about their investment portfolios and the underlying investment strategy in the present environment. With this letter we hope to provide you with some answers to those questions while at the same time reinforcing the idea of maintaining a long-term perspective.

To paraphrase Warren Buffett; stocks, and to a lesser degree bonds, seem to be one of the few things in life that people aren't interested in buying more of when they go on sale. As they become more attractive in price and yield, people want less and less to do with them. Paradoxically, investors often confuse volatility with risk. In the case of stocks, unless one believes that the vast majority of businesses will become insolvent, the chance to buy these businesses "on the cheap" virtually assures a good long-term outcome. Ditto bonds; buying the issues of high quality companies at large discounts to their face values with double-digit yields, incorporates a very large margin of safety and should prove to be very rewarding in the future.

With the cash positions in our managed accounts, we have spent much of October buying what we believe to be attractively priced securities in all shapes & sizes; common stocks, preferred stocks, bonds and secured bank-debt. In short, much of what is being liquidated by those who have been forced to sell. This is not a call on where we expect prices to be next week or next month. We are also not trying to suggest that all is rosy and that the general economy will do well in the immediate future. It won't, that we're reasonably sure of. House prices are still declining, unemployment is climbing, and credit markets, while improving after the massive government capital injections, are still fragile. Things will however, eventually improve. Therein lies the conundrum with regards to investing.

Markets are anticipatory. If one waits for the clouds to disappear and the uncertainty to vanish, bargain prices will have vanished as well. And with them will go the exceptional returns offered by those low prices. The seemingly simple goal of investing- to buy low and sell high- is frequently turned upside-down by investors. One need only examine mutual fund inflows over time to see this phenomenon in action. Inflows are largest after several years of good performance by stocks; i.e. higher prices, and outflows peak after several years of poor performance; i.e. lower prices. According to TrimTabs Investment Research, nervous investors pulled an estimated $70 billion out of mutual funds in October. As Yogi Berra says "It's déjà vu all over again."

We recognize that viewing your account statements after a month like the one just ended can be disconcerting. While we share your concern- as we are also investors ourselves in many of the same securities- we by no means regard the current situation as permanent.

In closing, it is our belief that the prices of many securities in the stock and bond markets are divorced from the economic reality of their businesses and represent a wonderful opportunity for patient investors.

We thank you for your patience and your trust.

Highlander Capital Management, LLC