

November 21, 2008

Dear Friend,

As of yesterday, the Diversified portfolio has outperformed the S&P 500 by 8.9% net of fees and 4.2% for the Concentrated portfolio.¹

However, after yesterday's 7% decline the S&P 500 is down 48% for the year – 52% since its peak in October of 2007. This peak to trough decline now exceeds the 44% decline that stocks suffered in the 1973-74 bear market.

No one knows where the stock market will bottom. Current prices are far below what I believe to be fair value. However, while investors have historically been too optimistic and paid too much for stocks at the peak, they, by the same token, have been too pessimistic and paid too little for stocks at the bottom.

The other day I spoke with a client who managed money during the 1973-74 bear market. He described a situation very much like our current one. He and his colleagues would buy quality companies at very low valuations and then they would decline. They would then buy more shares and the stocks would decline still further. One day in December '74, he said, the volume just dried up. The sellers had exhausted themselves and in January the market began to rocket upwards. By the end of that year the market was up 35% and by the end of 1976 the market had recouped nearly all of its losses. Now, thirty four years later, my client's memories are mostly of the unbelievably low prices he was able to pay for great businesses.

¹ Preliminary performance figures are unaudited. Past performance may not be indicative of future results and every investment program has the potential for loss as well as profit. The diversified equity composite is the dollar-weighted linked monthly return of those accounts sharing the objective of a diversified equity portfolio that are greater than \$250,000 in size. The concentrated equity composite is the dollar-weighted linked monthly return of those accounts sharing the objective of a concentrated equity portfolio that are greater than \$250,000 in size. Accounts are added to the composite on the first day of the month following our first 30 days of managing the account and must be in the composite for a full calendar quarter before inclusion. Portfolios are excluded as of the last full calendar month under management or at such prior date as Integre Advisors receives notice of termination. Individual account results will vary from that of the composite based on fee structures, investment restrictions, the timing of contributions and withdrawals and other factors. Comparisons to the S&P 500 Total Return are for informational purposes only, as the composites may hold securities not in the S&P 500 and may have more or less volatility and risk than an investment in the S&P 500.

No one knows what will happen this time, but in a bull market every stock goes up and while there may be good reasons for that, the reality is that there are just more buyers than sellers. A bear market is just the opposite. Everything goes down and while there may be good reasons for that, the basic reason is supply and demand, more sellers than buyers. This is why no one can tell you when the market will bottom. People can tell you when things might bottom, that is, when it would make sense for the market to bottom based on the value of the businesses that make up the market. But no one can tell where it will bottom.

If there is serious money to be made from here -- which I believe, which Warren Buffet believes, which market strategist, Jeremy Grantham, who has been bearish for the last 10 years, believes -- that must be the focus for long-term investors and not the avoidance of an unpredictable market bottom which thirty four years from now might just be a hazy memory.

I am not a cheerful Pollyanna. I sold my last bank stock in 2007; got rid of my last retailer in January; and held 28% cash heading into this decline. These measures helped - - not nearly as much as I would have liked -- but it helped us go down less than others. Now I want to share with you my current strategy.

- 1) Continue to avoid banks and risk-taking financials. 20% of the homeowners in this country owe more on their home than their house is worth. More loans are going bad.
- 2) Avoid retailers. As the American consumer is forced to save, retailers will suffer.
- 3) Avoid companies that will need to borrow money in order to pay off their debts when they come due. If credit markets do not improve they will be forced to make dilutive equity offerings.
- 4) Keep a large cash position until companies bring down earnings expectations to a level they can actually beat. (As a mid-size asset management firm we have the advantage of being able to get in and out of markets quickly and efficiently).

Wishing you all the best in this difficult period,

Manny