

October 8, 2008

Dear Client,

As you well know, the news out of Wall Street has been grim. The government just passed the largest bail-out bill in history. Two weeks earlier, it loaned AIG, the world's largest insurer, 85 billion dollars. And a week before that, it guaranteed all of Fannie Mae and Freddie Mac's debt, a potential exposure of one trillion dollars. The investment bank and brokerage industry has been decimated. Lehman Brothers and Washington Mutual went bankrupt. Wachovia and Merrill Lynch were forced into mergers at fire-sale prices. Goldman Sachs and Morgan Stanley have been forced to substantially reduce leverage and accept federal regulation. The resulting reduction of lending capacity is seriously impacting Main Street with corporations now having severe difficulties replacing maturing loans and the average person no longer being able to get something as simple as an auto-loan.

As a result of all this turmoil, the S&P 500 declined 8.4% for the third quarter and 19.2% for the first nine months of the year. In this period of declines it is extremely difficult to earn a profit. We were, however, able to significantly out-perform the S&P 500. For the quarter, our Diversified Equity Composite declined 3.0%, outperforming the market by 5.4%. For the first nine months of the year it declined 13.3%, outperforming the market by 5.9%. Our more volatile Concentrated Equity Composite declined 3.7% for the quarter, outperforming the S&P by 4.7%. For the first nine months of the year the Concentrated Composite declined 13.3% outperforming the S&P by 6.0%.¹

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.

The recent stock market declines have been upsetting and unnerving, even life-changing for some. But it is important to remember that since we began managing money in 1998 there have been three bear markets with declines comparable to that of the current one: the Asian Crisis in the second quarter of 1998, the quarter following the September 11th attacks of 2001, and the Enron/Worldcom crisis of third quarter 2002. In all of these quarters our Diversified Equity Composite declined by 15% or more. Yet since we started managing money in July 1998, our Composite has generated a 140% return, gross of fees, and that includes this quarter's decline.

Going forward it is clear that we will live in a world with less leverage. Bear Stearns won't be making any loans, nor will Lehman Brothers. The survivors -- Goldman Sachs and Morgan Stanley -- both need to substantially reduce the size of their balance sheets, that is the size of the loans they can make relative to their equity base.

Getting to this world with less leverage will be an arduous process. One byproduct of it is the credit freeze currently rattling the markets. On the margin, institutions that have made or own loans are unwilling or unable to renew those loans as they come due. As a result, there is now a shortage of capital in the financial system and so rates for junk bonds and all types of loans, as well as dividend yields on securities and limited partnerships, have substantially increased. What this means is that for now cash is king.

The good news is that your portfolios have lots of cash. At the end of the third quarter, the Diversified Equity Composite had 22.9% in cash; the Concentrated Equity Composite, 22.5%. We have been putting this cash to work slowly as we have found companies with strong balance sheets and/or stable cash-flows selling at steep discounts to our estimate of what they would be worth in an economic recovery. Currently some of these companies are trading at their lowest price-to-earnings valuations since the early 1990's. In addition, over the past four months we have been able to make highly selective investments in financial companies trading as though they were distressed. This perception changed for the better once the government began intervening in attempt to stabilize the markets.

While cash is now king, that will not always be the case. Cash is only king if one puts it to work when others are desperate to borrow it. After that period ends, cash once again becomes just, well, cash. The current forced liquidations of hedge funds and the investor pessimism and panic that exceed post-9/11 levels are good indications that the current market is a target-rich environment. However, it would be foolhardy and inconsistent with our goal of preserving capital to put it all to work at once.

As a result, we are moving slowly, taking opportunities as we find them. Like Warren Buffett, who recently invested \$5 billion in Goldman Sachs and \$3 billion in General Electric, we are spending only some of our cash, saving for the future as we cannot know what other opportunities may arise and at what prices. That said, the current climate is unnatural. Credit cannot stay frozen forever. Money has been loaned for interest throughout history. Money will naturally seek the highest return as soon as rates are high enough to encourage risk-taking. And when that happens there is plenty of money on the sidelines waiting to move, 3.4 trillion dollars just in U.S. money market funds alone.

When the market climate is good it is hard to remember that it will ever deteriorate. Conversely, when the market climate is bad it is hard to see how it will ever improve. While we cannot know how long the credit freeze will last, we believe we are well-positioned whether it proves to be a short or long-term phenomenon. In either case, we will continue to work hard to preserve your capital and make select opportunistic investments as we find them.

In difficult times like these, we are grateful for the steadfastness of your support and your commitment to our belief that successful investing requires a long-term outlook and a willingness to buck prevailing sentiment. As always, but especially in a period like this, we welcome the opportunity to discuss your portfolios and address any concerns.

Sincerely,

Emanuel Weintraub, CFA
Managing Director