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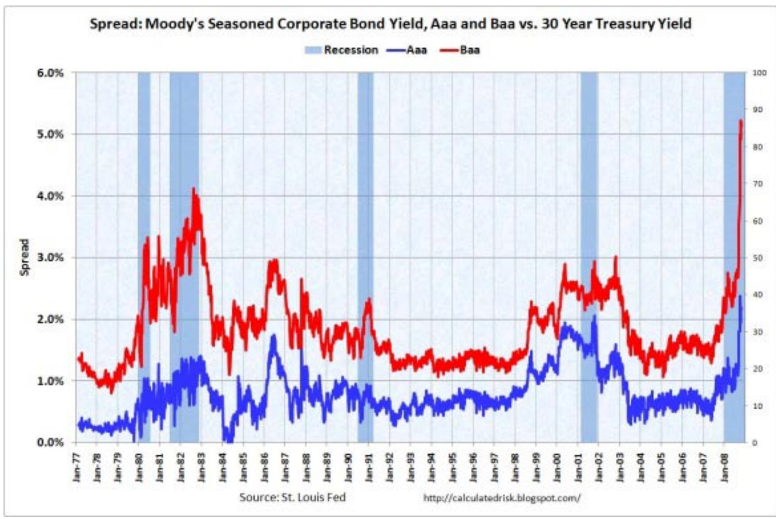
Dear Clients and Friends:

As 2008 winds to a close, we sift through the rubble of razed asset prices to formulate a new strategy for the year ahead. This past year was marked by extremes. Volatility in the global equity markets (defined as the implied daily price fluctuations of market constituents) has increased to levels rarely witnessed in history and never before as pervasive and lingering. Crude oil reached its highest price ever, trading to $147 in mid-July, only to collapse a staggering 75% in six months to a recent level of $38 per barrel. Global stock markets witnessed peak-to-trough corrections of 50%-70% from October 2007 to November 2008. Declining prices in high-yield and investment grade corporate debt, municipal debt, and bank loan instruments led to the highest credit spreads *(yields relative to risk-free U.S. Treasuries pictured here)* in over 30 years. And, credit availability swung from unprecedented access by sub-prime borrowers with little or no documentation supporting their ability to repay, to the outright suspension of lending at many banks to even their best customers.



In our most recent letter in September 2008, we noted the fragility that existed in the financial market, comparing it to a garden in desperate need of irrigation. We speculated that if the water were turned back on in time, meaning both credit and confidence were to flow again, we might survive the drought without losing the lawn for an entire season (cycle). At the time, we were optimistic that the Paulson plan formalized as the Troubled Asset Relief Program, having passed in The Senate, would pass in The House of Representatives with all due haste. The House however, failed to pass the Bill on the first try, and compounded the drought in doing so.

In hindsight, it is likely that a swift passage of the Bill would have done little to reverse the eventual unwinding of the extraordinary leverage that had built up in financial markets around the world. However, the panic that ensued as a result of this legislative uncertainty only exacerbated an already precarious situation and created a spiral that led to indiscriminate selling among all, particularly liquid, assets, irrespective of innate qualities or differences among investments. Perhaps a more orderly disposition of the excesses would not have been possible. Certainly, Bernard Madoff, the unscrupulous charlatan who presided over the largest and seemingly most blatant investment fraud in history, would not have volunteered to turn himself in solely because of a suddenly heavy conscious.

We remain concerned about the pervasive, though decreasing leverage in the financial system, the overburdened U.S. consumer, and the deflating real estate price bubble fueled by easy access to credit. These factors have contributed to the asset price collapse we are currently witnessing, as various entities around the world repay borrowed money and curb expenditures. But even more importantly, these factors have contributed to create an elemental and threatening challenge to wealthier societies around the globe including ours: complacency with respect to how we assess risk, foster innovation, and sustain competitiveness.

For several years now, we have been discussing the challenges we face as a nation with regard to ongoing global competitiveness and our place in the world as the baton is passed East from a single superpower to a more balanced power structure to include, among others, China and India. Our reliance on foreign investment and foreign oil has allowed us to live at a high standard and consume freely. During that time, we have dramatically underinvested in our national infrastructure. Our bridges and roads are in disrepair, our water infrastructure is in need of replacement, and our electric grid is outdated. Our educational standards are lagging much of the first world, and we have failed to train our youth to compete with other children around the world who have better skills in math and science. We continue to subsidize obsolete industries and business models with taxpayer dollars and yet fail to send long-term price signals to the markets to incentivize climate change remediation and energy independence. Without such signals, market participants are precluded from making strategic and expensive, long range investments that could lead to more sustainable and economically viable solutions. These are fundamental challenges that we desperately need to address in a revolutionary way. Our hope is that out of the ashes of this ongoing asset liquidation, we as a nation may reprioritize to strengthen our global position for the future.

CREATIVE DESTRUCTION

> Society, community, and family are all conserving institutions. They try to maintain stability, and to prevent, or at least to slow down, change. But the organization of the post-capitalist society of organizations is a destabilizer. Because its function is to put knowledge to work--on tools, processes, and products; on work; on knowledge itself--it must be organized for constant change. It must be organized for innovation; and innovation, as the Austro-American economist Joseph Schumpeter (1883-1950) said, is "***creative destruction***." It must be organized for systematic abandonment of the established, the customary, the familiar, the comfortable--whether products, services, and processes, human and social relationships, skills, or organizations themselves.
> ~ Peter F. Drucker, Post-Capitalist Society, p. 5

Despite the recent carnage, there is much for which to be hopeful. The post-World War II model, to which we have grown accustomed, has been destroyed. While certainly painful, we believe this destruction inspires the opportunity to build a better model going forward, one that can help sustain our prominence in the world.

Over the next decade, we have the opportunity to take the initial steps toward long-term energy independence, thereby increasing our national security. Instead of enriching the heads of Middle- Eastern and Post-Soviet nations, we can direct capital toward reducing the spending gaps in education and infrastructure and maintaining a strong national defense, uncompromised by the need to play along with OPEC nations in determining policy. We can devise a sensible climate change policy that signals long-term targets to carbon emitters about costs, thereby forcing weak players out of the market and prompting nimble players to invest in and adapt clean technologies that will help maintain the livability of the planet for our grandchildren. We have the opportunity, through this painful deleveraging process, to re-price assets to their true economic value (without the levered mark-up) and uncover fraudulent and under-supervised market participants through sensible regulatory oversight in previously unregulated derivatives markets. In summary, we as a nation and as investors may emerge leaner and better positioned for the next wave.

VALUE AND OPPORTUNITIES

"Even the intelligent investor is likely to need considerable willpower to keep from following the crowd."

~ Benjamin Graham

For much of 2008, we carried significant cash in our investment portfolios in an effort to soften the downside. We also attempted to position portfolios with some defensive investments that provide income and in what we believed were undervalued stocks. This strategy garnered some success given that the financial markets have been so tumultuous and that assets of every stripe have deflated virtually in unison. Such has been the case for bonds, stocks, commodities, real estate and art, save one notable outlier- - the U.S. Treasury bonds. The Barclays 10-20 Year U.S. Treasury Fund has appreciated over 20% in 2008, a trend we expect to reverse course over the coming 18 months.

With equity prices having corrected to such a degree, we believe a significant amount of ongoing economic distress has been priced into these markets. There are certainly opportunities to build a buy list for purchase in mid 2009, namely of technology stocks, clean energy stocks (wind, solar, smart grid), generic drugs and healthcare solutions, and various other deep value situations. However, with unemployment continuing to increase, home prices continuing to fall, and commodity and credit markets yet to stabilize, *we are not convinced that the all clear has sounded*.

Over the near term, the best value resides in the corporate loan and convertible bond markets and the preferred equities market. In these markets, we can move up the capital structure (strengthen our claim on company profits) and still potentially earn an equity-type return. The best place for us to take advantage of these unique and, potentially short-lived, entry points is through investing in closed-end funds. While we have and will continue to purchase individual corporate bonds in our portfolios, closed-end funds present unique opportunities as we head into 2009. Many of these funds have suffered large losses, further pressured by tax loss selling. Closed-end funds trade like stocks and seek to track the value of the underlying assets they hold in their portfolio, known as Net Asset Value (NAV). Because, in part, of dramatic selling pressure in October and November, many of these funds are trading at discounts to their NAVs. As a result, we can buy these funds, essentially the claims to the distributions of the assets within the fund, for less than the value of those assets. When the market finally begin to heal, whether 6 months or two years from now, we will profit from the contraction of these spreads as funds re-price to NAV. We view this as a very sensible way to remain exposed to opportunities in the market's upside when things stabilize, without taking the risk of a 100% common stock allocation. Once we begin to forecast the likelihood of an economic recovery 6-9 months in the future, we can transition out of some of these investments if warranted and back into stocks.

As we close the books on a challenging year, let us embrace the opportunity to create something new. Best wishes to you and your families for a joyous holiday season and a prosperous 2009.

Kind regards,

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