

FOURTH QUARTER COMMENTARY

Los Angeles, December 31, 2008

Dear Fellow Investor:

The deep and abiding impact of this quarter's events make any neat summary here impossible. Papers and books will be written for many decades about what has occurred in many markets recently; so, rather than attempt the impossible, here are just a few of the most important points about the quarter's developments:

1) Volatility (read fear) reached all-time highs.

2) Economic conditions worsened materially, but comparisons to the Great Depression are far off the mark at this point. The comparison is more appropriate in regards to financial market conditions.

3) Governments around the world intervened frequently, haphazardly, and heavy-handedly in an effort to forestall the impact of the downturn. The breadth of this market intervention, even if out of necessity—and regardless of one's political philosophy—may produce unintended consequences. This could exacerbate an already treacherous investment landscape.

4) Stock prices sank. In fact, prices within nearly every asset class save one, government issued bonds, sank.

The S&P 500 closed at 752 on November 20, a level the market first surpassed twelve years earlier in November 1996. The full year return for the S&P 500 (down 37%) was among the worst ever and the current decade (cumulative return, including dividends, since December 31, 1999 is -28.1%) is yielding worse stock market performance than the 1930s.

We were previously uncertain whether the current downturn would be cushioned by what we perceived then to be already low valuations for our portfolio companies, or whether a steeper downturn would present us, as long-term investors, with

a generational buying opportunity. The market provided us an immediate answer: the latter.

We recognize that lower prices don't necessarily translate into better values. Business conditions have worsened. Indeed, in all likelihood, despite our aim to be conservative in our estimates and ever-conscious of the business cycle, we have lowered some of our appraisal estimates as a result of this quarter's developments. But it is clear to us that stock valuations—what you get (in assets or future cash flows) for what you pay—are more attractive than at any time in at least the last twenty years. Stock valuations generally correlate inversely to fear and directly to investor expectations for economic conditions. Investors are so flooded with genuinely bad news at the moment that it is difficult to remember two important lessons from history. First, normal business conditions will resume at some point, likely within one to two years. Second, equity prices tend to be leading indicators of economic performance and they have historically tended to trough about midway through past recessions.

“Over five to 10 years, we expect investor's remorse is more likely to be felt by those who stay on the sidelines in cash and Treasuries than those who buy stocks today.”

This doesn't mean stocks can't get cheaper. Broadly speaking, they were overvalued for long periods, and can remain undervalued for long periods as well. There is no rule (can we all agree now that markets aren't always efficient?) that stocks can't go from cheap to spectacularly cheap, to borrow a phrase from investing sage Jeremy Grantham.

Broad macro-economic overviews are not our strength and they are, for better or for worse, not what drives our decision-making, so we won't dwell much further here. Rather, what follows is a closer look at the portfolio's performance and makeup.

NEW INVESTMENTS:

WASHINGTON POST (WPO)
NESTLE (NSRGY)
EMERSON ELECTRIC (EMR)
CISCO SYSTEMS (CSCO)

INCREASE IN EXISTING INVESTMENTS:

WALGREEN (WAG)
WELLS FARGO (WFC)

REDUCTION IN EXISTING INVESTMENTS:

JP MORGAN (JPM)
APOLLO GROUP (APOL)
WAL-MART (WMT)

INVESTMENTS SOLD:

TICKETMASTER (TKTM)
APOLLO GROUP (APOL)

Portfolio Review

Preliminary estimates indicate that the average Bristlecone Large Cap Value portfolio declined about 27% during the fourth quarter, worse than the 22% decline for the S&P 500 and the Russell 1000 Value. For the full year 2008, our average portfolio

was down about 41%, compared to a decline of 37% for both the S&P 500 and the Russell 1000 Value index. The table below shows the annual, cumulative and average annual returns against the broader market:

Large Cap Value Composite Returns Through December 31, 2008¹

Year	Non Wrap Composite Net of Fees (1)	S&P 500 with Dividends Reinvested (2)	Relative Results (1) - (2)
2000	15.0%	-11.1%	26.1%
2001	-6.5%	-11.9%	5.4%
2002	-19.2%	-22.1%	2.9%
2003	25.9%	28.7%	-2.8%
2004	10.5%	10.9%	-0.4%
2005	5.2%	4.9%	0.3%
2006	19.0%	15.8%	3.2%
2007	-8.1%	5.5%	-13.6%
2008	-41.3%	-37.0%	-4.3%
Average Annual Gain/Loss Since Inception	-2.3%	-4.0%	1.7%
Cumulative Gain/Loss Since Inception	-18.5%	-29.7%	11.2%

¹ PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS. Performance quoted is that of the Large Cap Value Non Wrap Composite net of fees. Investment returns for the composite and the S&P 500 include the reinvestment of dividends and/or interest income. Inception is April 1, 2000. Prior to June 2004, the composite represents performance generated by the portfolio management team at a prior firm and includes wrap accounts. A list and description of all firm composites is available upon request.

Although the portfolio continues to outperform the S&P 500 since our track record's inception, we are clearly disappointed with our underperformance during the current downturn. We consider our investment philosophy conservative and would wager that the portfolio will outperform more often than not in down markets. Candidly, only time can bear this out. Meanwhile, a bad quarter, even a bad year, is almost a sure thing every once in a while given our contrarian philosophy and focus on a relatively small number of investments. Last year was irrefutably a bad year.

It is hard to single out the negative contributors to performance, as nearly all of the portfolio's stocks were down in the quarter. The largest contributors

to the negative performance were financial stocks Bank America and American Express; consumer discretionary stocks Harley Davidson and Liberty Interactive (whose main business is the QVC shopping network); and Sprint.

The financial sector remains the epicenter of the current crisis, as losses on loans of all types continue to mount. Each of the three banks held in the portfolio, along with American Express (which converted to a bank holding company during the quarter) received capital injections from the U.S. Treasury. This capital strengthens their balance sheets, and comes on better terms than the companies would have received in the market, but it also dilutes our ownership and initiates a highly



Portfolio Review

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uncertain partnership between private shareholders and the government. On top of that, each of the banks (Bank of America, JP Morgan, and Wells Fargo) concluded transformational acquisitions during the quarter. On their own, each buy would have been a major story, with talk of altering the financial industry's landscape, but as it is these stories were all overwhelmed by the larger torrent of the financial crisis.

We view very favorably the acquisition of Washington Mutual by JP Morgan and Wachovia by Wells Fargo. These purchases bring valuable branch networks and large deposit bases, while costing very little. We believe these acquisitions add meaningfully to the value of our investments in the acquiring companies. We are less certain about Bank of America's acquisition of investment bank and brokerage leader Merrill Lynch. The price paid would have seemed ridiculously low two or three years ago, but seemed rich in the context of other crisis-driven deals. Furthermore, it dilutes Bank of America's more stable, core retail banking franchise. Our conclusion at this point is that the deal will add value to Bank of America over the long-term, but at the expense of some near-term uncertainty (and ugly headlines).

One of the few bright spots during the quarter was Apollo Group, a stock we owned (this go around) for less than six months. It will not be a regular practice to take short-term gains, but here the circumstances were unusual. The stock appreciated more than 50% in that short period, thanks to improved fundamentals and the perceived defensive nature of education (if you can't find a job, you go back to school). That appreciation coincided with nearly every other stock going on sale, which made swapping into a cheaper name all the more sensible. Other positive contributors were Bristol-Myers Squibb, Waste Management, Exxon Mobil, and Emerson Electric.

The volatility of the markets created a good flow of opportunities, and we were net purchasers in the quarter. Several long-lusted-after businesses fell to prices that had us doing double-takes. No matter how disappointing the short-term performance, we focus our attention on what we can control, which is making well-reasoned investment decisions about what goes into the portfolio to generate long-term returns.

Simply put, we have always sought high quality companies run by good managers and trading at big discounts. In most markets, indeed throughout our careers, we have ended up compromising, to some degree, on one of these three elements because they rarely come packaged neatly together. This quarter, we added three new names to the portfolio where we felt we not only got the whole package, but at unusually large discounts: Washington Post, Emerson Electric (which will sound familiar since we've owned it for long periods before), and Cisco Systems. The common theme among these is quality; these are companies that lead their respective industries, generate attractive returns on invested capital, and are led by managements who are smart, dedicated, and think and act like owners.

Washington Post, for those who don't know, is much more than the owner of the namesake newspaper. Like most others, we foresee tough times for the newspaper business, but the Washington Post has smartly reinvested its sizable profits from publishing into other businesses like education (Kaplan, which now accounts for the majority of the company's value, in our opinion) and cable. That these investments have been made under the eyes of a board stacked with legendary investors (Warren Buffet, Tom Gayner, and Chris Davis, to name a few) is a great comfort.

Cisco Systems may seem out of character for a value portfolio, and we are typically shy of owning technology companies for fear that a better mousetrap is inevitably being created in some garage somewhere in the world. But Cisco is an almost incomparably productive company. The stock has performed terribly since the peak of the technology bubble when it traded at \$82 in 2000. In the meantime, though, the company has continued to grow nicely, increasing revenues from \$19 billion in fiscal 2000 to \$40 billion in fiscal 2008 and profits three-fold over the same period. Cisco dominates the router and server markets—the core infrastructure required to move data—and has pioneered several more innovative business segments that might prove valuable in the future. In a time when debt is an extra heavy burden, Cisco carries more than \$26 billion of cash on its balance sheet (exceeding its debt load by \$20 billion).



Looking Ahead

It is unlikely that this quarter's losses will be recovered as quickly as they were suffered. But there is good reason to believe that they will be recovered over time. We contend, after reviewing all the portfolio's holdings and incorporating new inputs where necessary to account for the worsened economic conditions, that the portfolio is generationally cheap, that it is to say, cheap in a way that investors should see only once or twice every 20–30 years. After more than a decade spent tempering client expectations of future returns, we now find ourselves having trouble convincing investors that there is real return potential latent in the portfolio. At present levels, we judge the portfolio to be trading at a greater than

50% discount to what we see as the intrinsic value of the underlying companies, a condition we believe is very favorable for future performance.

Our advice for this time of financial crisis is to take a deep breath; stay rational; save a little more than you used to (a recent ad captured the moment nicely: "there is no such thing as saver's remorse"); and keep investing with money that is truly long-term in nature. A one to two year horizon will always be impossible to predict. But over five to 10 years, we expect investor's remorse is more likely to be felt by those who stay on the sidelines in cash and Treasuries than those who buy stocks today.

Bristlecone Update

Since we formed Bristlecone Value Partners almost five years ago, we've aimed to communicate with you frequently, openly and honestly about our successes and failures. In this spirit, there were some developments concerning the firm during 2008 that we wanted to share with you.

Bristlecone experienced significant loss of assets under management last year due to the decline in the markets and the loss of clients associated with a subadvisory investment management agreement that we had with our previous employer.

This lower asset base forced us to reconfigure the firm in order to reduce costs, including, unfortunately, laying off staff. The latter was the most difficult decision, but the operational complexity of the firm decreased substantially due to the lower number of accounts, custodians, and systems that we work with.

Because this turn of events was not completely unexpected, the firm had prepared first by building reserves over the last few years, and second, by laying out contingency plans. We believe that we have today the necessary resources to continue offering quality investment management services, to growing our asset base and building revenues

going forward. Each of the remaining personnel has committed substantial capital to the firm or its investment products, and has a deep vested interest in the success of Bristlecone.

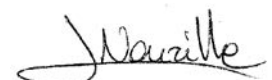
On a more positive note, we are tremendously excited about the investment opportunities that we see in the market today; we strongly suspect (though, of course, cannot guarantee) that patient, long-term equity investors will be well rewarded over the next few years.

We appreciate your patience and trust as we navigate the current market. We encourage you to visit the Bristlecone web site to stay abreast of communications and enroll in our email distribution list (<http://www.bristlecone-vp.com/news.htm>). As always, please feel free to call us if you have any questions or concerns.

As we start 2009, we wish you and your families a happy and prosperous New Year.

Sincerely,


David Fleer
Portfolio Manager


Jean-Luc Nouzille
Portfolio Manager

CAUTIONARY STATEMENT

One of Bristlecone Value Partners' principles is to communicate frequently, openly and honestly. We believe that our clients benefit from understanding our investment philosophy and process. Our views and opinions regarding the investment prospects of the portfolio are "forward looking statements," which may or may not be accurate over the long term. While we believe we have a reasonable basis for our appraisals, and we have confidence in our opinions, actual results may differ materially from those we anticipate. Information provided in this report should not be considered as a recommendation to purchase or sell any particular security. You can identify forward looking statements by words like "believe," "expect," "anticipate," or similar expressions when discussing prospects for particular portfolio holdings. We cannot assure future results and achievements. You should not place undue reliance on forward looking statements, which speak only as of the date of this report. We disclaim any obligation to update or alter any forward looking statements, whether as a result of new information, future events, or otherwise. Our comments are intended to reflect trading activity in a mature, unrestricted portfolio and might not be representative of actual activity in all portfolios. Portfolio holdings are subject to change without notice. Current and future performance may be lower or higher than the performance quoted in this report.