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Second Quarter Commentary

Los Angeles, July 15, 2009

New Investments:

None

Increase in Existing Investments:

EOG Resources (EOG)
Markel (MKL)

Reduction in Existing Investments:

Intel (INTC)

Investments Sold:

Liberty Media Entertainment (LMDIA)

Dear Fellow Investor:

As good as the second quarter was, the bounce off the March bottom is as much a reflection of the rough road just travelled as it is an indicator of the market's health. To illustrate, understand that it took a 900 point drop in the S&P 500 (Oct. 2007 – March 2009), to make the quarter's 120 point move look so good.

It also took the bleakest of economic outlooks (some investors anticipated financial Armageddon) in March to allow for such still obviously grim economic news to be characterized as "green shoots." Nonetheless, the combination of a very low starting point and a slightly less dire economic picture combined to produce Bristlecone's best ever quarterly returns (since the inception of our track record in April 2000); this just two quarters after our worst ever (4Q 2008). After six straight quarterly losses, you could say investors deserved some relief.

The quarter's gains were shared broadly across nearly all stock markets, indices, market caps, styles and sectors, but we're pleased to report that Bristlecone's portfolios performed particularly well: the average Large Cap Value portfolio increased by about 21% during the period. This was materially better than the S&P 500, which returned about 16%, and the Russell 1000 Value, which rose just under 17%. The table below shows the long-term and recent cumulative and average annual returns against the broad market:

Large Cap Value Composite Returns Through June 30, 2009[1]

	Since Inception	5 Year	3 Year	1 Year
Annualized	-1.5%	-5.3%	-13.5%	-25.9%
S&P 500	-3.4%	-2.2%	-8.2%	-26.2%
Cumulative	-13.2%	-23.7%	-35.3%	-25.9%
S&P 500	-27.5%	-10.7%	-22.7%	-26.2%

[1] PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS. Performance quoted is that of the Large Cap Value Non Wrap Composite net of fees and may include estimates for the most recent quarter. Investment returns for the composite and the S&P 500 include the reinvestment of dividends and/or interest income. Inception is April 1, 2000. The US dollar is the currency used to express performance. Bristlecone Value Partners, LLC ("Bristlecone") is a registered investment adviser founded on June 1, 2004. Prior to June 2004, the composite represents performance generated by the portfolio management team at a prior firm and includes wrap accounts. Bristlecone claims compliance with the Global Investment Performance Standards (GIPS®). A list and description of all composites and/or a presentation that complies with the requirement of GIPS is available upon request.

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In Praise of Cycles

Even with US stock markets 30% or so above their lows, there is no guarantee that the worst from this bear is behind us. We can, however, say several things with relative confidence: 1) The worst of the cycle, in terms of certain headline-grabbing data such as bankruptcies, loan defaults, and unemployment, is still in front of us (these indicators tend to lag the economic recovery). 2) The stock market will not traverse a straight line back to a more normal valuation (even after the recent rise, we believe the market, and more importantly our portfolio, still trades below an average valuation of normalized earnings). 3) However long and dizzying the path, the market will eventually revert to more normalized valuation levels (probably overshooting to the upside, if history is any guide). 4) Corporate earnings will not return to 2007 levels any time soon. 5) Notwithstanding this, the vast majority of companies in the market, and in our portfolio, are making the necessary adjustments to improve profits over current levels.

There has been much fretting in the financial press over whether the markets have come too far too fast, whether we are due for a correction. This is wasted speculation; investors should expect corrections to occur regularly. Although the most recent downturn was extreme by any measure, periodic declines of 10% - 20% are a quite common and natural part of market dynamics. Investors are better served by learning to identify specific investment opportunities that market cycles generate than they are by attempting to time broad short-term corrections or rallies. In fact, a wider general understanding of cycles by investors, consumers, managers, and legislators would go a long way toward curing our recent ills and improving the fundamental health of our economy, in ways ranging from stronger individual balance sheets to smarter risk-taking to better—rather than greater—regulation.

Financial Stocks Rebounded Strongly

The biggest story, perhaps, to come out of the second quarter was that the financial system did not collapse. It is fair to conclude, however, that the system, as we knew it two years ago has disappeared for good. Many major players no longer exist. The government became a large investor in hundreds of financial institutions. Egregious behavior and a vicious economic cycle have energized legislators and regulators to consider transformative changes. The familiar landscape of the prior 20 years has been permanently changed.

Yet, it is clear now that many, in fact most, financial firms will survive largely intact. Battered and diluted, but intact. It is also clearer now that some of our holdings scored major acquisition coups during the downturn (JP Morgan, Wells Fargo) that will yield sizable, enduring benefits to us as shareholders. This realization drove the financial sector as a whole up 36% in the quarter, and the biggest contributors to our performance were Wells Fargo (+ 71%) and American Express (+73%). JP Morgan and American Express have repaid the government's investment (the thorny issue of the government's warrants to purchase stock is still unresolved). Even Bank of America, the weakest of our credit-exposed holdings, was able to raise huge amounts of capital through stock sales, preferred stock conversion, and asset sales. We suffer dilution as current shareholders, but raising that kind of capital was something unimaginable in the first quarter.

Other significant contributors to the positive performance in the quarter were Expedia, Dell, and Motorola. The consumer discretionary and information technology sectors (our second and

Financial Stocks Rebounded Strongly

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third largest sector weights, after financials) were also up very strongly in the quarter. The largest negative contributors during the quarter were Cintas, Wal-Mart, Bristol-Myers, Vulcan Materials, and Markel. No common or industry theme explains the weakness in these stocks.

Portfolio activity was minimal during the quarter, since we were already fully-invested and few stocks traded near our assessment of their full value. With so many cheap, quality stocks to choose from, it took some discipline to not simply trade out old cheap stocks for new cheap stocks. Our only purchases during the quarter were increasing existing holdings in Markel and EOG Resources. To fund these, we sold Liberty Media Entertainment. This was the last vestige of our investment in DirecTV (the key underlying asset of LMDIA), an investment that worked out extremely well for investors and a stock that held up surprisingly well during the bear market.

Markel and EOG Resources are good examples of companies we like to own. Markel, which operates within specialty niches of the property and casualty insurance sector, is run by superb managers with an excellent underwriting record and a top-notch investment team led by Tom Gayner. Markel is a fraction the size of Berkshire Hathaway, but it shares a few key characteristics of that model company. EOG Resources, as a reminder, is a large natural gas and oil producer. After a string of large new discoveries and fast production growth during the boom years, natural gas is suffering a weak pricing cycle. EOG is a smart, low-cost provider, and stands to benefit as prices move back towards what we forecast to be a higher equilibrium level. Both Markel and EOG were bought at large price-to-value discounts.

Bristlecone on the Move!

On an administrative note, we are in the process of moving our office to a new location, a mile or so down Wilshire Boulevard. Our new address will be 12301 Wilshire Boulevard, Suite 320, Los Angeles, CA 90025 and will be effective on August 1. Our phone numbers and email addresses remain the same. Give us a few weeks to settle down and then please come visit us.

As always, we appreciate your continued trust in Bristlecone's services.

Sincerely,

David Fleer
Portfolio Manager

Jean-Luc Nouzille
Portfolio Manager