COLBERT INVESTMENT MANAGEMENT CO.

Core Equity Composite Portfolio Annual Report
December 31, 2007

On a relative and an absolute basis, our investment results in 2007 have been dreary.

I normally review past decisions to understand not only what happened, but also to identify any failure in the thought process that lead to a negative outcome. As usual, there are no guarantees, but I promise to be candid with you.

An abbreviated appraisal of the portfolio's evolution during the year, along with what we think might happen in the future, is hereby presented.

Hall of Fame

Since inception in December 2001 Berkshire Hathaway's super-safe, yet cheap, attributes have always made it a large client portfolio holding. Over the next 4 years, Berkshire Hathaway's operating businesses made good progress, however investors were not biting. By 2005 the stock had become an incredibly attractive opportunity, so we jumped in, feet first; increasing its weighing from roughly 12% of client accounts to nearly 20% (please see our 3rd Quarter Report – September 30, 2005 at www.colbertinvestment.com). Up nearly 70% since we upped the stake, our largest stock investment has been one of our star performers in 2006 and 2007. The gold medal winning group in 2007 includes energy plays Canadian Natural Resources and Harvest Natural Resources, in addition to Liberty Global, Covidien, First Data, KKR Financial, and, Liberty Capital.

Silver Medals

On my way to watch a tennis match in Key Biscayne a few years ago, I saw some guy wearing a t-shirt which read: "I didn't lose. I just fell a little behind and ran out of time". A fitting analogy to the list of companies whose intrinsic value generally increased but whom saw their stock price fade or drop steeply towards the second half of the year. ABX Air, American International Group (AIG), Borders Group, DISH Network (formerly EchoStar), Dell Computer, IAC/InterActiveCorp, Liberty Interactive, Penn

West Energy Trust, UnitedHealth, Target, Tyco International, Western Union, Xerox are strong candidates to graduate to the gold medal rank in the next year or two.

Dog house

A bunch a mixed-bag of disappointments (probably including yours truly), dismal management or businesses simply going through rough times. Entities like Delia's, Foamex International, H&R Block, Meade Instruments, and Sprint Nextel have lost some real value, but their share price went down even more. Although in retrospect we should have avoided them, their current discount-to-value renders them attractive investments to own today. They could either perform better or may be replaced with a quality contender.

Hall of shame

a) Sea Containers is an example of a "value trap": an evaluation reveals that if the company were to liquidate (sell) its assets, pay off all its debts, one would end up with a price worth a multiple of what is trading for today. Unfortunately, weak management and high debt levels weaken the company so much over time that it ends up being worth little (or nothing) for shareholders.

b) In November 2006 I sold Citigroup which we had owned for a very long time -even though my admiration for its global franchise had not dimmed- because I concluded that management was destroying value. Since then, banks and other financial stocks including Citigroup have gone down a lot, making me seem prescient. On the other hand Delta Financial was better managed than most, had relatively conservative accounting and lending policies (with loan-to-value criteria of below 80% versus many banks lending 90%, 100% or more of the home value), a valuable mortgage-servicing group, etc. It is a participant in the Alt-A market, lending to borrowers whose credit history puts them between the lowest quality ("subprime") and the higher ratings ("prime"). It received new investments which should have enabled it to not only survive the credit crunch currently going on the USA, but also thrive in the future due to reduced competition and improved profitability. Financial institutions (banks, etc.) live on the public's confidence by "warehousing" other people's money, lending it to more people, and keeping the spread (profit) between both sides. If other people stop giving them their money, they fail, no matter how adequate their lending policies. That is what happened to Delta Financial. My normal focus on the particularities of a company (management, cash flows, assets, competition, etc.) failed to completely account for the fatal credit environment.

Diamonds in the rough

To the naked eye, Oesterreichische Post (Austrian Post), RHJ International and Sears Holdings probably belong in the dog house due to their lackluster results. Once you drill down to the fundamentals regarding their respective managements, assets, operations and financial structure, a forceful light emerges from these unpolished rocks. Even if I wouldn't dare predict when the hidden beauty might reveal itself, I have reason to believe that, over many years to come, they could prove to be celebrated winners.

The bottom line

In summary, our collection of 32 companies was 25% fantastic (8 out of 32), 43% close-but-no-cigar (14/32), 9% too-early-to-say (3/32), 16% bad (5/32), 6% terrible (2/32). We would clearly improve by eliminating the terrible, even as limiting the bad. However, in my judgment, not much can be done when a big chunk (43%) of the companies make good overall progress, nevertheless to be penalized by the markets. On a positive note, most of these stocks are trading as if we were already in a recession, rendering them safer now than before their decline.

Looking ahead, while aware of the real estate, inflation (energy), credit (debt) and other inter-related economic threats, I am especially energized about the overall composition of our equity portfolio. Time and again, history has shown that buying in uncertain times leads to exceptional profits, because uncertainty in itself is not a risk of loss. Accordingly, I have personally invested more funds recently and encourage you to do the same.

Please call, write or email me (ka@colbertinvestment.com) with any questions or comments. In the meantime, thank you for your continued trust, and I wish you and your family all the best in 2008.

Sincerely,

Karim Armand
President

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