COLBERT
INVESTMENT
MANAGEMENT

Our company manages Fixed-Income, Balanced and Equity portfolios. This report refers only to the Equity portion of client assets.

Core Equity Composite Portfolio Annual Report
December 31, 2008

"It is extremely difficult to go against the crowd--to buy when everyone is selling or has sold, to buy when things look darkest, to buy when so many experts are telling you that stocks in general, or in this particular industry, or even in this particular company, are risky right now." -- Sir John Templeton

Altana AG

Altana AG, the world's largest maker of additives for coatings and plastic parts, is based in Wesel, Germany. Its shares started 2008 trading at 16 euros per share.

At a press event on October 22, 2008 its Chief Executive Officer called the current economic maelstrom an opportunity where he would make more acquisitions, not less, to take advantage of weaker competitors. Five days later its already battered stock reached a new low of €7.53, down over 52%. Needless to say, nervous investors were less than impressed.

EBIT

At €7.53 per share Altana was selling for 6.4x EBIT (short for **E**arnings **B**efore **I**nterest and **T**axes, a measure of operating profit or cash flow). By comparison, in July 2008, less than 4 months before, Dow Chemical agreed to buy another specialty chemical leader Rohm & Haas for over 16x EBIT. Granted the financial markets in late October were in a free fall so nobody in their right mind would pay that kind of price multiple to operating cash flow.

However, if you bought a leading company like Altana at 6.4x EBIT, waited five years, it should be worth at least 13x EBIT (or <u>double</u> the €7.53 per share you bought it for). In addition, if Altana executes on its opportunistic strategy to acquire other businesses at the very cheap prices we are now witnessing, the company's operating income could be up 50% or more in 5 years, which in turn means their stock price could be worth more than <u>triple</u> October 2008's low price.

Who is Susanne Klatten?

On November 6, 2008 Altana's controlling shareholder, billionaire Susanne Klatten, offered to buyout the 49% she didn't already own for €13/ share or 910 million euros in cash. The offer thrilled existing shareholders who were taken out at a large premium to the recent price. Still, I think she got a better deal than the selling stockholders: the purchase price amounts to 11x EBIT. Klatten is an heiress of the Quandt family, which owns 47% of BMW.

More EBIT

- Centennial Communications, a wireless phone company, opened 2008 at $9.50 per share, then dropped 81% to a low of $1.80 by October 10. On November 7th AT&T offered $8.50 in cash or 11.4x EBIT (including debt) in a takeover.

- Mentor, a surgical product manufacturer, began 2008 at $40 per share before losing 65%, bottoming out below $14 on November 20. Johnson & Johnson bought them at $31 per share in cash on December 1 for the equivalent of over 15x EBIT.

Core Equity Portfolio

Most of the companies we have currently sell for less than 10x EBIT. Most sell for less than 6x EBIT. In fact, a bunch sell for less than 3x EBIT. Some even sell for less than net cash in the bank! On average our Core equity Portfolio sells for roughly 5.8x EBIT. If they were to sell for an average of 11x EBIT, our whole portfolio would almost double from here and still be inexpensive.

This is only one way to look at how undervalued our holdings are. It does not make any (necessary) adjustments for quality of the business, short-term challenges and long-term opportunities. Thus it is meant as an illustration with no predictive powers of how your equity portfolio is well positioned to not only weather the ongoing turmoil, but also to reward you for staying the course.

Nowhere to Hide

Our portfolio is a selection of companies whose respective prices are relatively low. That relative undervaluation should result in a margin of safety whereby in a bad year we should drop less that the S&P 500, while doing even better in a good year. The last year or so have turned everything upside down: lower priced stocks in general have performed much worse than more expensive ones. Consequently although our collection of businesses on average have not lost as much intrinsic value as the S&P 500, their respective stock prices dropped to a much greater extent than expected.

If our portfolio was already cheaper than the S&P 500 index, how come we did worse than expected? Clearly, some of our holdings have suffered decreases in intrinsic value. On the other hand, the recent panic and ongoing forced-selling made the S&P500 index trade at levels which assume an extremely severe recession. Low price-to-earnings stocks, like the ones we own, are now trading as if we are going into a full-blown depression.

Buying a Mercedes Benz for the price of a Toyota

During the wicked 4th Quarter 2008 volatility we repositioned some holdings by selling the merely discounted equities while buying the ridiculously cheap. For example, in December we reduced or sold 6 positions at an average price of 9x EBIT even as 7 other holdings were increased or newly bought at an average price of about 5x EBIT. Sometimes we simply exchanged a good company for a world-class leading business at similar price-to-EBIT, thereby improving our lot.

> *"A few months ago I told the American people I did not trade arms for hostages. My heart and my best intentions still tell me that's true, but the facts and the evidence tell me it is not." -- President Ronald Reagan on Iran-Contra*

Is Susanne Klatten thinking with her heart? Are the executives at AT&T and Johnson & Johnson oblivious to the harsh economic outlook? Maybe.

In light of recent top management failures of epic proportions, a healthy dose of skepticism is warranted. My take on corporate executives is a twist on Henry Kissinger having said that 10% of bad politicians give the rest a lousy reputation. This decade's events suggest instead that a large number of terrible CEOs have tarnished the minority of first-rate executives.

That being said, I trust in cash. I trust in cash flow. Whenever you can buy quality businesses for 2-, 4-, or 6- times operating cash flow you know that emotions are running the show. As you can see from the examples like Altana, Centennial, and Mentor, even if their respective stock price was down 52%, 65% or 82% it doesn't equate to their underlying intrinsic value. The facts tell me that bonds and equities represent the steals of this young century.

With kindest regards and every good wish,

Karim Armand

DISCLAIMERS AND OTHER LEGAL INFORMATION

This letter ("Letter"), and any information and research contained herein, do not represent recommendations of investment advice to buy or sell securities or any financial instrument nor are they intended as an endorsement of any security or investment. **This Letter is for informational purposes only and any information contained in this Letter represents the writer's or provider's own investment opinions, and should not be construed as personalized investment or tax advice**. Nothing herein is an offer of any service that is not legal for offer into any particular jurisdiction with Colbert Investment Management Co. (together with all principals, affiliates, employees, and associated persons thereof collectively being referred to herein as "CIM") current licensure (if any).

LEGAL AND OTHER INFORMATION. Any information, data, statements, opinions, or projections made in this Letter may contain certain forward looking statements, projections and information that are based on the beliefs of CIM as well as assumptions made by, and information currently available to, CIM. Such statements in this Letter reflect the view of CIM with respect to future events and are subject to certain risks, uncertainties and assumptions (including, but not limited to, changes in general economic and business conditions, interest rate and securities market fluctuations, competition from within and without the investment industry, new products and services in the investment industry, changes in customer profiles, and changes in laws and regulations applicable to CIM. Should one or more of these or other risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this Letter. Furthermore, although carefully verified, data is not guaranteed as to accuracy or completeness. The statements, opinions, and/or data expressed in this Letter are subject to change without notice based on market and other conditions. Descriptions of CIM's process and strategies are based on general practice and CIM may make exceptions in specific cases. This Letter is based on information available as of the time it was written, provided, or communicated and CIM disclaims any duty to update this Letter and any content, research or information contained therein. Accordingly, CIM does not make any representation as to the timeliness of any information in this Letter. As a result of all of the foregoing, inter alia, CIM can not be held responsible for trades executed by the recipients or viewers of this Letter based on the statements, projections, research, or any other information of any other kind included therein. ***Investments in securities are speculative and involve a high degree of risk; you should be aware that you could lose all or a substantial amount of your investment if you attempt to apply any of the information in this Letter.***

The information contained herein is confidential and may not be reproduced or circulated in whole or in part.

***DISCLAIMERS AND INFORMATION RELATED TO ALL PERFORMANCE DATA**. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS AND FUTURE ACCURACY AND PROFITABLE RESULTS CANNOT BE GUARANTEED. PERFORMANCE FIGURES ARE PRE-TAX AVERAGES OF INDIVIDUAL YEAR'S RESULTS. ALL PERFORMANCE IS NOT NECESSARILY BASED ON THE SAME TYPES OF GAINS. THE AMOUNTS MANAGED MAY DIVERGE FROM THE AMOUNTS UNDER MANAGEMENT THAT FORMED THE BASIS FOR HISTORICAL PERFORMANCE. ALL PERFORMANCE ASSUMES THE REINVESTMENT OF EARNINGS. THE U.S. DOLLAR IS THE CURRENCY USED TO EXPRESS PERFORMANCE. ACTUAL INVESTMENT ADVISORY FEES INCURRED BY CLIENTS MAY VARY. INVESTMENT ADVISORY FEES ARE DESCRIBED IN CIM'S FORM ADV PART II. UNLESS OTHERWISE SPECIFIED, ANY PERFORMANCE IN THIS LETTER IS NOT AUDITED AND IS NOT INTENDED TO COMPLY WITH AIMR-PPS™ OR GIPS GUIDELINES. NO REPRESENTATION IS BEING MADE THAT FOLLOWING THIS LETTER AND/OR ANY INFORMATION CONTAINED HEREIN WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN OR DESCRIBED IN THIS LETTER. ANY INVESTMENT RETURN AND PRINCIPAL WILL FLUCTUATE WITH MARKET CONDITIONS, AND YOU MAY HAVE A GAIN OR LOSS ON YOUR INVESTMENTS. ACCORDINGLY, INDIVIDUAL RETURNS, FOR ANY GIVEN ACCOUNT OR YEAR, MAY VARY FROM ANY OF THE RELEVANT RETURNS SHOWN HEREIN.

ANY PERFORMANCE COMPARISON TO THE PERFORMANCE OF INDICES IN THIS LETTER MAY NOT BE A MEANINGFUL COMPARISON. INDICES CITED IN THIS LETTER ARE GENERALLY NOT AVAILABLE FOR DIRECT INVESTMENT AND ARE NOT SUBJECT TO FEES. ANY PERFORMANCE REFERENCED IN THIS LETTER IS NOT NECESSARILY BASED ON THE SAME TYPES OF SECURITIES CONTAINED IN ANY INDEX SHOWN OR REFERENCED IN THIS LETTER, NOR IS ANY SUCH INDEX REPRESENTATIVE OF ANY PERFORMANCE PRESENTED IN THIS LETTER. HEDGE FUNDS MAY USE SHORT POSITIONS, DERIVATIVES, AND LEVERAGE, UNLIKE SOME OF THE COMPONENTS OF SOME OF THE INDICES. ANY INDICES SHOWN IN THIS LETTER ARE ONLY TO REFLECT COMPARATIVE PERFORMANCE OF FAMILIAR OR OTHER INVESTMENT STYLES. NO REPRESENTATION IS BEING MADE THAT ANY STOCKS, PORTFOLIO, INDICES, FINANCIAL INSTRUMENT, INVESTMENT OR FUND (INCLUDING THE FUND) WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN OR DESCRIBED IN THIS LETTER. ACTUAL PERFORMANCE WILL VARY BASED ON MANY FACTORS, INCLUDING, BUT NOT LIMITED TO, INVESTMENT STRATEGIES, TAXES, MARKET CONDITIONS, AND APPLICABLE ADVISORY AND OTHER FEES AND EXPENSES.

****PERFORMANCE INFORMATION AND DISCLAIMERS RELATED TO THE CIM CORE EQUITY COMPOSITE**. CIM MANAGES FIXED INCOME, BALANCED AND EQUITY PORTFOLIOS, BUT ONLY RELEASES DATA HERE ON THE EQUITY PORTION OF CLIENTS' ASSETS. SIGNIFICANT DISPERSION MAY OCCUR BETWEEN THE PERFORMANCE, HOLDINGS, RATIOS AND PERCENTAGES SET FORTH ABOVE AMONG THE ACTUAL INDIVIDUAL CLIENT ACCOUNTS MANAGED BY CIM. THIS DISPERSION MAY BE DUE TO DIFFERENCES IN ACCOUNT SIZE, CASH FLOW, THE TIMING AND TERMS OF EXECUTION OF TRADES, INDIVIDUAL CLIENT NEEDS, ECONOMIC OR MARKET CONDITIONS AND OTHER FACTORS. PERFORMANCE FOR CIM CORE EQUITY COMPOSITE IS NET OF FEES AND EXPENSES. PERFORMANCE IS BASED ON ALL CLIENT EQUITY ACCOUNTS MANAGED BY CIM IN A SUBSTANTIALLY SIMILAR MANNER.