April 17, 2008

Enclosed is your statement for the first quarter of 2008.

For the quarter, equity investors saw total returns of -9.45% for the S&P 500, -7.00% for the Dow Jones Industrial Average and -13.88% for the technology-oriented NASDAQ. For the quarter, fixed income investors saw total returns of 2.23% for the 1-year Treasury Index, 5.55% for the 5-year Treasury Index, 5.78% for the 10-year Treasury Index and the 10-year BB- corporate bonds had total returns of -0.37%. Both the equity and fixed income returns reflect panic that credit problems may be spreading from sub-prime mortgages to the financial system generally. With the exception of recent purchases that we discuss here, our stocks have held steady through the turmoil.

In last year's first quarterly letter, we wrote: "Our approach to these times is the same as it was in either the Binges of past or the Disasters of past – to follow the admonition to "be fearful when others are greedy and be greedy when others are fearful." Binges are best met with "fearful" approaches, while Disasters are best met with "greedy" approaches." At that time, we perceived the securities markets, correctly as it turns out, to be in the Binge zone. Now we believe that they have moved into the Disaster zone.

A year ago, during the Binge, our "fearful" approach was to avoid companies which were leveraged, especially banks and investment banks. This approach worked doubly. The prices of the stocks we purchased using the "fearful" approach have held steady, while stocks of companies we perceived to be at risk and sold (for a decent profit) – MBIA, Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac"), have subsequently lost two-thirds or more of their market value.

But seasons change. During the last two quarters, we have shifted to a "greedy" approach, focusing on the stocks most damaged by the end of the Binge and the onset of Disaster. From within this "stock pile," (don't cringe – we've waited years to use that one) we have invested in three of the best (and we would add three of the best companies that we have ever owned) - Moody's, McGraw-Hill and Legg Mason.

Moody's and McGraw-Hill, through its subsidiary Standard & Poor's, have a virtual duopoly in the field of rating securities. Both companies are over 100 years old and have a combination of unusually high profit margins, excellent returns on capital and solid rates of growth – all marks of powerful franchises. Legg Mason is a highly successful money management firm with nearly $1 trillion under management, making it the seventh largest asset manager globally.

All of these companies are in disfavor (perhaps a mild word for some commentators) because of their involvement in the sub-prime mortgages market. In the case of Moody's and McGraw-Hill, their ratings did not correctly reflect the structural risks of

the new breed of complex financial products, while Legg Mason had exposure to these complex products in some of its funds. As a result, the stock prices of these three companies have dropped precipitously. The companies have certainly been damaged, both reputationally and financially, but we believe that the decline in the price of their stock is disproportionate to the decline in their real corporate value. We believe that these companies will continue to serve critical and highly profitable roles in the financial world.

Their stock prices have dropped as the banking sector continues to surprise investors. Where "the bottom" is, we don't know. As is our practice, we have been increasing our ownership of these stocks on any major price drop (typically 20% or more) from our initial purchases. This practice has dampened our relative success as measured against the market for the past quarter, but has proven to be our best means of outsize investment results historically. So, despite the short term drops, we are excited by this investment opportunity.

We do not mean to minimize the real emotional and financial pain associated with this Disaster zone. Binges are much more pleasurable. While investment possibilities have increased, we also realize that Disaster zones are generally lengthy and difficult. This one is likely to be no different. However, just as we personally experience healthier growth through painful periods than we do through lush ones, we are optimistic that the economy will be more structurally sound, more resilient and better regulated at the other end of this wrenching period.

We hope this letter helps you understand our process. We want you to stay informed and feel comfortable about our investing discipline. If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or Sue Compton at our office. In addition, our website (at www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio.

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management