October 23, 2007

Enclosed is your statement for the third quarter of 2007.

For the quarter, equity investors saw total returns of 2.03% for the S&P 500, 4.19% for the Dow Jones Industrial Average and 3.98% for the technology-oriented NASDAQ. For the quarter, fixed income investors saw total returns of 1.77% for the 1-year Treasury Index, 4.17% for the 5-year Treasury Index, and 4.72% for the 10-year Treasury Index and the 10-year BB- corporate bonds had total returns of 1.51%. The quarter presented equity and fixed income investors with generally positive returns, masking high volatility. In the first half of the quarter, investors saw dramatic downturns as credit squeezes surprised the markets. For the second half of the quarter, investors saw an equally dramatic recovery as the Federal Reserve dropped the discount rate in order to reverse the deteriorating credit environment.

We don't typically address any one quarter in particular because we believe that it takes the focus off of our efforts towards building long-term, high quality portfolios. Many quarterly investment reviews address very short investment horizons, resulting in a vacillation between chest-thumping references to "beating the markets handily" and defensiveness about being "stunned by the developments" in some aspect of the global economy. Such an approach does not seem helpful to us. But this quarter's characteristics are worthy of discussion.

We purchased the shares of more new companies during this quarter than in any prior quarter. Generally, we consider the purchase of five new companies per year to be a good year's work. But, during the third quarter's volatile environment we purchased *seven* new companies (listed alphabetically):

Burlington Northern
Covidien LTD
Hershey Foods
Legg Mason
McGraw-Hill Co.
Moody's Corp.
Time Warner Cable-A

Not only was the number of companies purchased unusual, but the quality was as well. We group our companies into three broad categories based on their durability. While all of the companies we purchase are attractive, some of these businesses have a "greater moat around their castle" than others. These are grouped into the top tier as the most durable; the other tiers are an attempt to rank the remaining companies. We typically get to purchase a company from the top tier once every three or four years. During the past quarter, *three* of the companies purchased were from our top tier.

We enjoy the purchase of new companies, but it's tricky work. We are "catching falling knives," meaning that we typically buy companies when their stock prices are declining. We maintain a significant base of researched companies whose stocks we would like to own at a specified price. Sometimes, we actually "buy at the bottom," where the price drops to our desired number and then rises after we have purchased the shares. But usually this is not the case.

Most of the time, we purchase shares and the price continues to fall. This is generally good for us because we purchase additional shares if the price drops further (generally 20% or more). This happened *three* times during the third quarter as we increased our positions in Legg Mason, McGraw-Hill Co., and Moody's Corp.

Our investment results lagged the market indices for the past quarter, causing our year-to-date results to lag as well. This does not make us happy, but neither does it cause us distress. We realize that the more aggressively we purchase these "falling knives," the higher our risk of mediocre short-term investment results. Yet, in order to generate superior long-term results, we need chaotic investment environments so that we can make purchases of good companies at very reasonable prices. The past quarter provided us just what we needed.

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