January 17, 2008

Enclosed is your statement for the fourth quarter of 2007.

For the quarter, equity investors saw total returns of -3.33% for the S&P 500, -3.91% for the Dow Jones Industrial Average and -1.62% for the technology-oriented NASDAQ. For the quarter, fixed income investors saw total returns of 1.40% for the 1-year Treasury Index, 4.58% for the 5-year Treasury Index, and 5.29% for the 10-year Treasury Index and the 10-year BB- corporate bonds had total returns of -0.41%. In general, the quarter penalized risk and rewarded safety. During the quarter, investors saw increased volatility and decreased liquidity in the markets. In response, the Federal Reserve dropped the discount rate in an attempt to calm the markets.

Last year, we began a fourth quarter letter tradition by discussing the investments which have generated the best results for the year. While reviewing investment gains is enjoyable, we believe that it can help you better understand our process.

In 2007, our lead gainer both in percentage gain (over 80%) and total dollar gain was the stock of Apollo Group (APOL). Apollo Group's largest subsidiary is the University of Phoenix. The educational stocks have long been a staple of our approach because their business "moat" is significant. In fact, demonstrating not only a strong desire to own these stocks, but a willingness to try new techniques, we asked our clients back in 2000 to pray for "downward pressure on for-profit educational stocks." (The subsequent upward movement in those stocks relieved us of the temptation to use that technique again.)

Of course, the stock price movement of 2007 was not the only story behind our APOL investment. In our "catching falling knives" technique, we purchased our first position of APOL at $54 in January, 2006 as it fell from $80 only months earlier. A few months later, the price dropped 20% and we more than doubled our position at $43. Then, only a couple of months later, the stock then dropped an additional 20% and we purchased another sizeable position at $35. Because APOL was our *worst* performer for 2006, the low prices created both an opportunity to increase our ownership threefold and to generate outstanding returns (25%+ per year).

This telling two year saga of APOL illustrates an important point that we have repeatedly made – market volatility is our friend. The lower the price APOL went, the less risk we saw in our investment. When an investment has less risk, we are willing to commit more capital to it – and we bought much more APOL. At this point, we have completely sold our APOL position; so our clients can view the APOL chapter as happily closed.

Such a short turnaround is more fortuitous than expected (but welcome, nevertheless). As we have said repeatedly, a Rip Van Winkle outlook on investing is important. We evaluate a stock's value by discounting cash flows anticipated over the next ten years, seeking purchase at significant discount to that value. In order for this strategy to fully payoff, investors should think in terms of years or even decades. This is difficult when the media trumpets results measured in minutes, days and quarters. By spotlighting the results of our investment in APOL, we are not signaling a change to a short-term point of view. We are only trying to give you more insight into our process.

We hope this letter deepens your understanding. We want you to stay informed and feel comfortable about our investing discipline. In communicating, we try to "do unto others as we would want done unto us." 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