# Maverick

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**Maverick Performance**

| Net Performance | Third Quarter 2008 | One Year Ended 9/30/08 | Ten Years Ended 9/30/08 Annualized | Since 3/1/95 Annualized | Since 3/1/95 Cumulative |
|---|---|---|---|---|---|
| Maverick Fund Class C 5 yr. | (22.4%) | (16.9%) | 9.9% | 14.4% | 524.4% |
| Maverick Levered | (40.6) | (34.5) | 13.8 | 22.1 | 1,408.0 |
| Maverick Neutral | (14.4) | 0.0 | 6.2 | 10.9 | 306.3 |
| Maverick Neutral Levered | (27.5) | (3.3) | 8.0 | 16.8 | 726.8 |
| Maverick Long | (17.4) | (29.3) | 8.8 | 12.7 | 407.4 |
| Maverick Long Enhanced | (21.7) | (29.8) | 10.3 | 15.6 | 613.9 |
| S&P 500 Index | (8.4) | (22.0) | 3.1 | 8.5 | 203.3 |
| Morgan Stanley World Index | (15.3) | (26.0) | 3.8 | 6.5 | 136.7 |

The above results should only be read in conjunction with the Maverick Disclosure Statement found at the end of this letter.

October 9, 2008

Dear Investor,

Maverick's quarterly letters have always started with a brief sentence reviewing the strength or weakness of the previous quarter. Unfortunately, I cannot find words to describe our disappointment, embarrassment and shock over the above results. As you might suspect, in the past quarter our results were horrible in every sector and region in which we invest (although our returns in healthcare and emerging markets were arguably only disappointing.)

Ironically, October 1st marked Maverick's fifteenth anniversary, and from inception our stated goal has been "To preserve and grow capital." Since 1993 we have faced a number of bear markets and various crises around the world, and Maverick has consistently achieved this goal throughout such challenging periods. Indeed our hedged equity strategy has never suffered a down year – a streak that obviously appears to be in jeopardy.

As long-term investors fully recognize, these recent results are dramatically worse than any previous period in our history. The loss incurred in the past quarter was more than three times the prior largest quarterly loss ever for Maverick Fund. Even Maverick Neutral suffered a loss that was 2.5 times greater than its previous worst quarter. Not only is this the first quarter in which every one of our funds generated double-digit declines, this is only the third quarter in our history that more than two of our funds suffered such a drop.

Virtually all of the losses of the past quarter were suffered in the month of September. This performance was driven by a number of factors – hedge funds deleveraging, short regulations changing, equity markets imploding, prime brokers faltering, hedge funds failing and volatility spiking to name a few. To give you a feel for the persistency and extraordinary nature of these influences, of the five worst days in Maverick Fund's history (a sample of 3,428 trading days), four occurred in the past month.

As a result of this perfect storm, the equity markets are now full of stocks for which current market prices bear little correlation to the economic value of these securities. We have never experienced an environment where so many stocks are extremely under- and over-valued at the same time. As the markets return to rationality, these disparities will present enormous long and short opportunities for fundamental investors. Furthermore, both the number of long/short equity funds and the gross capital devoted to this strategy have plummeted. As a result, the prospects for long/short equity investors should be very rewarding in the near future.

Therefore, the most important objective at this point is simply to endure this unique turbulence to be positioned to take advantage of the far more productive environment that will exist on the other side of this nightmare. With that thought in mind, it is worth noting:

- We have reduced gross exposure (as you can see in the below table), and as a result the funds have the highest levels of cash and the lowest levels of leverage since January of 1997.
- The median average daily volume of our positions is now only 1 day – the most liquid Maverick has been since March of 2000. Theoretically, 75% of the portfolio could be liquidated in a week.
- To date, committed contributions from current and strategic investors for the next few months meaningfully exceed redemptions.
- 84% of Maverick's capital comes from investors who have been invested in Maverick for five years or more, and 60% comes from those that have been invested for ten years or more. Such stability is distinctive, critical to our success and much appreciated.
- Thanks to our decision to establish staggered fiscal years for the capital we manage and to the fact that a significant portion of our assets under management charge performance fees on an alpha basis, as opposed to an absolute basis, Maverick has already collected meaningful performance fees this year. This will enable us to compensate appropriately and retain our talented investment and operational teams.
- Over the years, the firm has built a capital reserve equal to one year's expenses, including salaries and bonuses. This reserve has never been touched, nor will it be necessary to do so this year. On the contrary, I expect we will choose to make a substantial addition to this pool of capital this year.
- The fourteen Partners of the firm are the largest investors in the funds, accounting for a fifth of assets, and remain firmly committed to our effort.
- I am only 44 years old, and my golf game is miserable.

Even though we never envisioned such disappointing results, for years we have endeavored to "storm-proof" Maverick for just such unforeseen circumstances.

As an investor, I find management teams that blame disappointing performance on environmental factors rather than their own poor decisions quite frustrating – and in reviewing the above I recognize that I have done just that, and I apologize. To be clear, I can think of several decisions we made over the last few months that we would change in hindsight. For example, given that the central topic of our last quarterly letter was our expectation of rising volatility, perhaps we could have been more aggressive in reducing our exposures. However, over time our success has been and will be driven by the strength of our fundamental investment process, and it is important to note that fundamental mistakes were clearly not the driver of this recent performance. In the attached piece, *A September to Remember (Even if we would like to Forget)*, Steve Galbraith explores this and several other factors behind Maverick's and the markets' wild ride last month.

Yesterday a potential employee asked me "Wouldn't it be easier just to hang it up rather than deal with these preposterous markets and the looming high water marks?" I told him: 1) I love what I do; 2) I am way too proud and competitive to walk away from the most compelling market opportunity I have seen in my fifteen years at Maverick; and 3) Maverick's investors have been wonderfully supportive of our effort over the years, and we fully intend to reciprocate this loyalty by honoring any high water marks we may face. I am confident that if he had posed this question to any of Maverick's Partners, he would have received an almost identical response.

As of today, Maverick's hedged equity strategy maintains the following exposures:

**Maverick Asset Allocation as of October 9, 2008**

| Net Portfolio Exposure | USA & Other | Europe | Japan | Emerging | Total Net |
|---|---|---|---|---|---|
| Consumer | 2.6% | 0.8% | 1.8% | 0.4% | 5.6% |
| Financials | 2.8 | 0.3 | 0.6 | 0.9 | 4.6 |
| Healthcare | 12.9 | (1.4) | – | – | 11.5 |
| Industrials | 5.3 | 1.0 | (0.9) | (0.4) | 5.0 |
| Media & Telecom | 2.6 | (0.2) | (0.1) | 3.1 | 5.4 |
| Technology | 9.8 | 2.4 | – | (1.2) | 11.0 |
| Small Cap | 1.2 | – | – | – | 1.2 |
| Other | 5.4 | – | – | – | 5.4 |
| Total Net | 42.6% | 2.9% | 1.4% | 2.8% | 49.7% |

Total Longs: 112.9% Total Shorts: (63.2%) Long/Short Ratio: 1.79x

Perhaps the only good news of the past quarter was the addition of two senior members to the Maverick team. Bill Goodell joined the firm on September 1st (great timing!) as our Chief Operating Officer and has been asked to coordinate our non-investment functions and to serve as a resource to those teams. Before joining Maverick, Bill spent ten years as the General Counsel of Tiger Management and served as the President of the Robertson Foundation. Bill also spent two years as the Chief Administrative Officer of Moore Capital. Before entering the hedge fund world, he was a Partner of King & Spalding. Bill serves on the Board of Trustees of Washington & Lee University, Episcopal High School and the Tiger Foundation. He received a B.A. in Political Economics (*Cum Laude*) from Williams College and a J.D. (*Magna Cum Laude*) from Washington & Lee University's School of Law. This is a new role for

Maverick, but as the complexity of our environment increases to have someone with Bill's experience and judgment has already proven to be of tremendous value.

Michael Moore joined Maverick in August as a Managing Director, and he will be working closely with Alex Rafal on Maverick's small cap and analyst training efforts. Michael spent six years at Pequot Capital where he co-founded the firm's telecommunications, media and technology equity fund and managed the firm's first foreign office. At Pequot, Michael was a Principal and Sector Portfolio Manager, the youngest at the firm to hold this post. Prior to that experience, he was a Research Analyst at Lehman Brothers and a Senior Business Advisor at Arthur Andersen. Michael received a B.B.A. degree in Accounting from the University of Georgia. Like Bill, many at Maverick have known Michael for years, and we are thrilled to have two individuals that we have held in such high regard as members of our team.

Each of the topics mentioned above deserve more discussion given our recent difficulties, but I believe our Annual Meeting will provide a much better format for such interaction. This year our meeting will be held on October 23rd in New York, and I hope to see you there. However, if you are unable to attend the meeting, we will make a webcast of this meeting available to our investors the following week. To gain access to this webcast, please call Amy Castillo at 214-880-4081 or email us at *annualmeeting@maverickcap.com*. Meanwhile, if you have any questions or thoughts, please do not hesitate to call me.

Sincerely,

Lee

Lee S. Ainslie III
Managing Partner

## MAVERICK DISCLOSURE STATEMENT

All performance figures shown are calculated by Maverick Capital, Ltd., investment manager of each of Maverick Fund USA, Ltd. ("USA"), Maverick Fund, L.D.C. ("LDC"), Maverick Fund II, Ltd. ("Levered"), Maverick Neutral Fund, Ltd. ("Neutral"), Maverick Neutral Levered Fund, Ltd. ("Neutral Levered"), Maverick Long Fund, Ltd. ("Long") and Maverick Long Enhanced Fund, Ltd. ("Long Enhanced"). Investment in the Funds (other than USA) is effected through investment in intermediate investment vehicles.

Unless otherwise indicated, Maverick returns are those of Hedged Equity Strategy ("HES") which became the total management style of USA and LDC as of March 1, 1995. The portfolios of Levered, Neutral, Neutral Levered, Long and Long Enhanced are comprised substantially of the same asset allocations as HES, weighted in accordance with the respective fund's long/short exposure targets. Neutral and Long generally do not incur substantial amounts of margin debt. USA, LDC, Levered, Neutral Levered and Long Enhanced incur margin debt in varying amounts as described in their respective Offering Memoranda. While the "investment mix" of the Funds may change over time, they have never been limited as to a specific type, quality or quantity of investment in which they may invest.

Net returns for the Funds (unless noted otherwise) are for March 1, 1995 through September 30, 2008. The returns of each of the Funds are computed on a time-weighted total return basis and include the reinvestment of all income derived from, and gains from the sale of, assets in the Funds' underlying portfolios. Ernst & Young LLP has audited the financial statements of USA, LDC, Neutral, Neutral Levered, Long and their respective gross monthly and net year-to-date returns from commencement of operations through December 2007. Ernst & Young LLP has audited Levered and its intermediate investment vehicles through June 2007, and has examined their gross monthly and net year-to-date returns through that date. Ernst & Young LLP has audited the financial statements and gross returns of Long Enhanced and its offshore investment vehicle through June 2007. Except as stated, data contained herein, including allocations among industries, regions and periods, is unaudited.

Unless otherwise indicated, net returns shown for the Funds reflect the deduction of all operational expenses (including brokerage commissions) and for the Funds other than Long Enhanced, a 1.5% management fee calculated on invested equity (including the proceeds of actual or deemed borrowings as described in the relevant Offering Memoranda) and, for the Funds other than Long and Long Enhanced, a 15% performance allocation or fee calculated on net profits (also as described in the Offering Memoranda). In the case of Long Enhanced, unless otherwise indicated, the management fee is 1% and performance allocations are calculated at a rate of 10% of net profits in excess of a return equal to the average of the S&P 500 and the MS World Indices (as defined below). Performance fees or allocations for the Funds are only charged on net profits in excess of losses from any prior period. Net returns would be reduced from those shown if an investor selected alternative fee structures offering greater liquidity at higher fee levels. Actual returns will vary from one investor to the next taking into consideration factors described in the respective Funds' Offering Memoranda. For example, annualized returns for the Funds other than Long and Long Enhanced from March 1, 1995 through September 30, 2008 reflecting a 2% management fee and a 20% performance allocation or fee are: Maverick 13.0%; Levered 19.4%; Neutral 9.8%; Neutral Levered 14.6%; the annualized returns for Long and Long Enhanced for the same period reflecting a 1% management fee and a 20% performance fee charged on net profits in excess of a return equal to the average of the Indices are: Long 12.0%; Long Enhanced 14.6%; and the annual return for HES for 2005 reflecting a 2% management fee and a 20% performance allocation or fee was (0.2)%. Net returns of the Funds and HES for other periods and under different fee assumptions are available upon request.

Net returns shown for a specific investment class reflect the management fee and performance fee/allocation rates applicable to the class and Commitment Period, as described in the applicable Offering Memorandum.

Levered commenced operations on July 1, 1998, and its performance returns related to periods commencing prior to July 1, 1998 are modeled by Maverick Capital, Ltd. on results of the HES portfolio for the period through June 30, 1998 and the actual experience of Levered for the remainder of the period indicated. Levered return data assumes estimated interest expense associated with modeled borrowings for the period through June 30, 1998 and actual interest expense associated with Leverage Feature borrowing (as described in the related Offering Memoranda) for the remainder of the period indicated. Neutral, Neutral Levered and Long commenced operations on January 1, 2005, and their return data is based on results for corresponding segments of the HES portfolio for the period through December 31, 2004 and the actual results of the respective fund for the remainder of the period indicated. Neutral Levered return data assumes estimated interest expense on modeled borrowings equal to investor capital for the period through December 31, 2004 and the interest expense on fund borrowings (as described in the related Offering Memoranda) for the remainder of the period indicated. Although Long Enhanced commenced operations on July 1, 2005, it changed its long/short exposure targets and fee structure as of October 1, 2007; its return data is based on results for corresponding segments of the HES portfolio for the period through September 30, 2007, adjusted to reflect its revised exposure targets and fee structure, and its actual results for the remainder of the period indicated.

Maverick Asset Allocation indicates the allocation among assets of USA, LDC and Levered, calculated on the basis of fair market values as of the day indicated, without regard to the fact that a portion of the amount invested may be funded with the proceeds of borrowings, and excluding certain non-HES assets of LDC which hedge liabilities and do not impact investor results. Maverick Neutral Asset Allocation indicates the allocation among assets of Neutral and Neutral Levered calculated on the same principles as of the day indicated. Maverick Long and Long Enhanced Asset Allocations indicate the allocation of assets of Long and Long Enhanced, respectively, calculated on the same principles as of the day indicated.

The S&P 500 Index, the MS World Index and the NASDAQ Composite (collectively, the "Indices") are generally considered appropriate benchmarks for various equity markets. The S&P 500 Index assumes dividends are reinvested unless otherwise noted. References to historical S&P 500 Index levels are based on S&P returns without dividends reinvested. The MS World Index is the MSCI World Daily Total Return Index (USD with dividends reinvested after deduction of applicable withholding taxes). Unless otherwise noted, the NASDAQ Composite assumes dividends are reinvested from January 1995 (first date available on Bloomberg). The Funds' portfolio of securities varies significantly from those in the Indices. Accordingly, comparing the results shown to the Indices may be of limited use.

Maverick Capital, Ltd. makes no representation, and it should not be assumed, that future investment performance will conform to past performance. Additionally, there is the possibility for loss when investing in the Funds.

**A September to Remember (Even if we would like to Forget)**

Over the past week, I read some 25 quarterly letters from many of our peers. Most are smart, capable folks with strong track records for balancing risk and return, many tested through prior tumultuous times. Others are newer to the world of managing money. There were, however, commonalities in each of the notes describing the past quarter and the environment. The tone of the discourse was funereal. A number of managers (even those with neutral to bearish dispositions) had their worst months ever in September. Gross and net exposures have been reduced, in many cases dramatically. Views on the macro outlook were understandably guarded. Yet to a man, using history as a guide, all expressed confidence in strong rebounds in their portfolios. I would like to say Maverick somehow stands out from the collective, but the reality is we do not. All of the above apply to us. So, rather than subject you to another somber missive filled with details of the triage that went on behind the scenes in the face of de-levering, a mid-game rules change on shorting by the SEC (where we went from playing chess to rugby at halftime) and every hedge fund playing musical chairs with its prime brokers I will focus on two questions. First, what financial factors drove stock returns in September (particularly relevant given we were almost flat on the year going into the month), and are they likely to persist? Second, what are the specific, current characteristics of our portfolio that give us confidence that expected returns should be extraordinarily attractive from here?

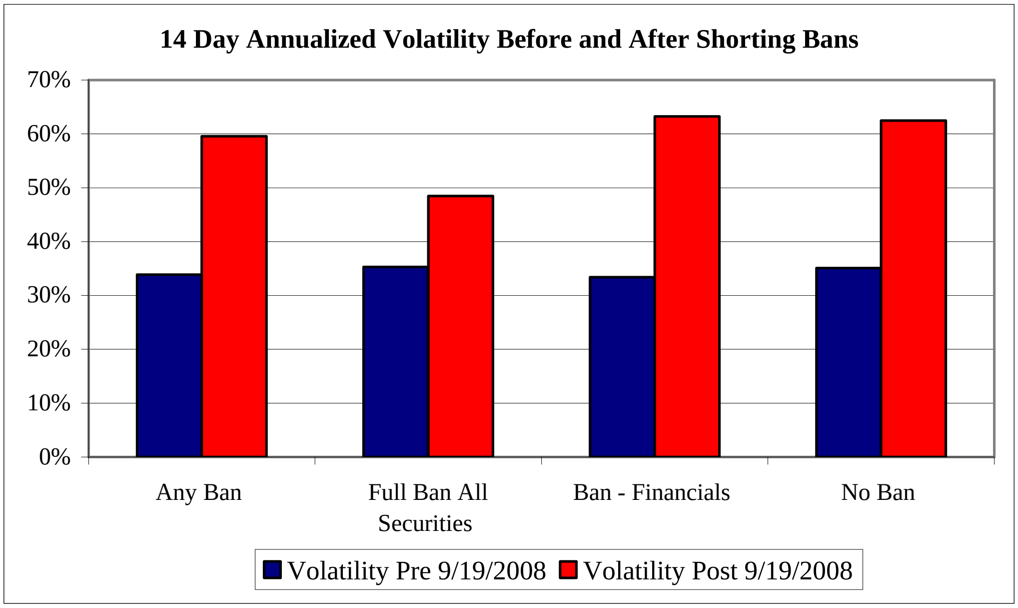
**Fundamentals and Prices Disconnect**

In many ways, September can be best summed up by the following: a week after the SEC chose to ban the short selling of troubled companies (calling it a ban on financial stocks was farcical; corporations ranging from internet incubators to retailers were added to the no-shorting list), China's Security Regulatory Commissioner put forth a proposal to *allow* short selling in the local market. My guess is both Ronald Reagan and Chairman Mao are rolling over in their graves. So perhaps it is not surprising that in a time when the Chinese sent one of the strongest messages possible that they are embracing capitalism while the U.S. appears on the cusp of abandoning free markets, we had our worst month in our fifteen year history (by a factor of two). While we made our usual share of individual stock mistakes in September, there were no more than a handful of instances where we materially had to reassess the earnings power of the company in which we were invested. Indeed, the data suggest most of the deterioration in our portfolio came from unfavorable changes in earnings multiples as opposed to current or, more importantly, forecasted earnings. The net result was that in September our longs became meaningfully cheaper while our shorts became relatively much more expensive. While such a circumstance can persist for a period of time, if we are right on the earnings power we are forecasting we stand to benefit nicely, prospectively, from these recent price moves against us. At the end of the day, we are investing in and selling short economic enterprises not pieces of paper. As such, rationality will ultimately prevail and the record degradation we experienced in the return spread between our longs and shorts in September should reverse.

**Beware Un-intended Consequences – So Much for the Short Ban Calming People Down**

Much has been made of the hedge fund hotel phenomenon that whipsawed the market in September; those companies with heavy concentrations of hedge fund ownership experienced extreme volatility in their share prices during the month as managers de-levered either for risk management purposes or in anticipation of impending redemptions. When combined with global bans on short selling, suffice it to say price discovery did not occur in an orderly fashion in September. Ironically, the order regulators sought to bring to markets by eliminating shorting actually resulted in *disorder* as market participants scrambled to put on or take off short exposures quickly. Exhibit 1 shows that those markets enacting a form of shorting ban were actually *more* volatile after the bans than before them (and no less volatile than markets that did not institute bans).

**Exhibit 1**




So how about calming the nerves of frazzled investors in financial stocks? Well, since the ban in the U.S. was put into effect, the KBW Bank Index had five of its 25 single largest price gains in history – and 4 of its 25 biggest price declines. This is remarkable. On one half of all the days the ban was in effect the bank index had a nearly record up or down move. My guess is this is not what regulators had been hoping to achieve. While we have little doubt that the overall panic in the hedge fund community buffeted our portfolio in a meaningful way, we have always paid attention to both fellow shareholders and short interest as part of our investment process. Indeed, lest anyone have concerns that our fund was simply caught up in a lot of crowded trades, it is worth noting that in September, of the 250 names in the U.S. with the highest concentration of hedge fund ownership we were only long 10 of them – furthermore, we were short 9 of these names. In my mind, the return of markets driven by economics rather than government fiat will be an important milestone toward restoring investment rationality. Supporting this idea, it is not coincidental that on the day the shorting ban in the U.S. was lifted Maverick had its single best relative performance day versus the S&P 500 in its history.

**Sector Exposure Allocations Exacerbated Our Poor Results**

As has always been our approach, Maverick maintains balanced exposures across both geographies and industry sectors. That is, we do not make directional bets on the market, sectors, or geographies but instead build our portfolio stock by stock with a degree of balance across the board. While our overall net portfolio exposure to the market tends to average about 50%, individual sector exposures can deviate 40 percentage points or more around this norm (e.g. our technology sector exposure could range from around 10% net to 90% net at a given time). While we may not have made an outsized share of mistakes on individual security selection in the month, we did err somewhat in allocating our net exposure (Exhibit 2) by sector during the month. While none of these exposures constitute abnormal weightings versus history, our cautious views on parts of the financial and consumer sectors and a relatively constructive view on the technology sector may have cost us a few hundred basis points of performance in September. While one can argue about the merits of maintaining slightly above average exposures to technology, even with the benefit of hindsight it is difficult to second guess our caution toward the financial and consumer sectors (where combined – it is worth noting - we actually *lost* money on the short side in September). Indeed, given the troubling outlook for both the financial system and the consumer our low net exposures to these sectors still appears warranted.

**Exhibit 2**

| | Average Net Exposure September 2008 | MSCI Sector Performance September 2008 |
|---|---|---|
| **Technology** | **77.4%** | **-14.8%** |
| Healthcare | 59.3% | -7.5% |
| Industrials | 44.9% | -15.4% |
| Financial | 41.8% | -9.4% |
| Media and Telecom | 37.5% | -12.1% |
| **Consumer** | **15.0%** | **-7.5%** |
| Maverick | 49.0% | |

Note: The KBW Regional Banking index, a subset of the MSCI financial sector was actually up 11% for the month of Sept.

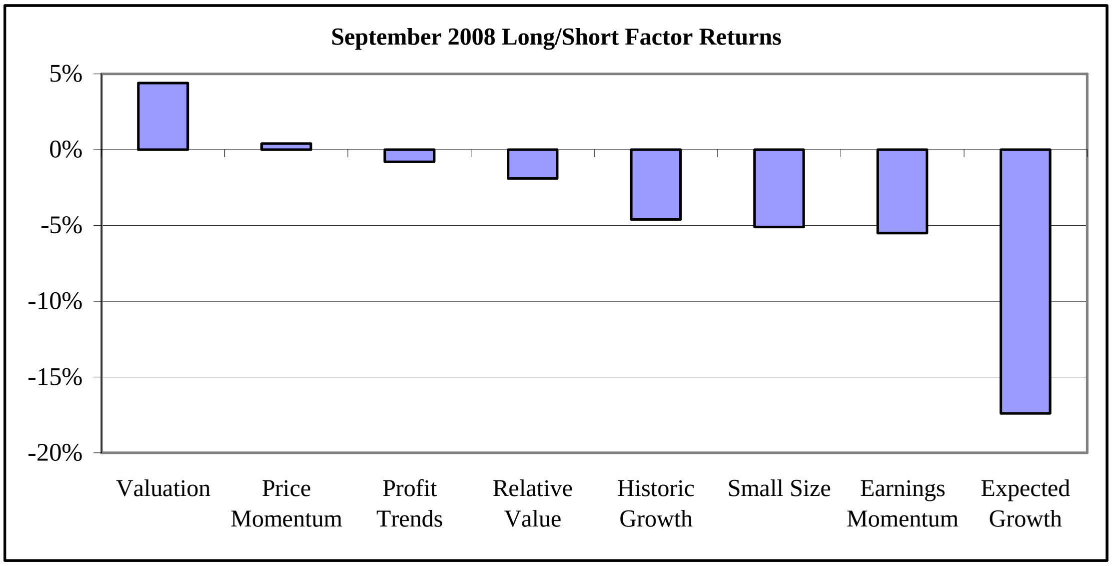
**Factor Returns in the Broad Market – Earnings are Irrelevant?**

Beyond capital allocation across sectors what else impacted our September performance? Well, the following chart and tables articulating those factors which drove stock returns in the month (courtesy of the Credit Suisse quant team) may shed some light. The methodology used to isolate which factors are driving stocks is straightforward: create a portfolio long the top decile of stocks exhibiting the best of a certain factor (e.g. cheapest on price to book) while shorting the bottom decile to determine whether that factor drove returns. For the most part, the data (Exhibit 3) suggest two things. First, virtually any of the fundamental factors Maverick looks at in selecting stocks did not work (stocks exhibiting the best relative valuations, earnings trends, earnings quality and so forth all produced negative returns versus those with the worst). Second, there was a very strong bias in the market towards naïve valuation factors with little account for fundamentals and away from stocks with any existing or forecasted growth expectations. On the margin, we have maintained something of a growth bias in our portfolio, owning companies where we believe fundamentals are still strong and improving beyond consensus expectations. So the flight from growth also incrementally hurt returns. Most striking (and frustrating) in the numbers though, is the fact that positive earnings revisions were punished relative to negative earnings revisions. Given estimates for our long investments were generally flat or rising in the month, while those for our shorts fell materially it is difficult to argue that we somehow missed a sea change in the operating fundamentals for companies in our portfolio. What we did miss was the market's *current* interpretation of those fundamentals.

**Factor Returns in Financial, Consumer and Technology Stocks were Extreme**

While the factors driving broad stock market performance in the month were somewhat unusual, the real story lies in looking at the granular level to see what drove stocks at the industry level. Here, the results were highly unusual. To be clear, losses were spread across sectors in the month – not one of our sectors was profitable. That said we had a particularly difficult time in the technology, consumer and financial arenas in September. Two key factors (Exhibit 4) stood out in driving such abnormal returns in the month. First, in the technology and consumer sectors those companies with the best growth and earnings quality trends were actually meaningfully penalized. Try as we might to prepare for this type of market, we will generally struggle in an environment where deteriorating fundamentals are rewarded and improving fundamentals punished. Second, in the financial sector there were stunning returns accorded to price momentum factors (i.e. stocks going up a lot, went up more - obviously turbo charged with the ban on short selling), irrespective of fundamental factors. Indeed, in the financial sector we are now experiencing something of a bubble in depository institutions as investors flee any company relying on wholesale funding while rushing to those companies with retail deposits. Amazingly, a number of regional banks actually reached all time highs on both an absolute and relative basis in September despite large asset quality issues looming. While accrual accounting may delay the earnings pain these banks will suffer, it does not eliminate it. In a nutshell then, in two sectors (technology and consumer) fundamental factors actually drove *perverse* returns while in the other (financials) all that really mattered was price momentum. Welcome to the nightmare that was September for our fundamentally driven strategy.

**Exhibit 3**




Source: Credit Suisse Russell 1000 universe

**Exhibit 4**

**September Long/Short Factor Returns**

| Factor | Consumer | Factor | Technology | Factor | Financials |
|---|---|---|---|---|---|
| Price Momentum | 8.0% | Relative Valuation | 6.2% | **Price Momentum** | **31.3%** |
| Valuation | 6.4% | Valuation | 2.3% | Earnings Momentum | 27.9% |
| Sales Acceleration | -1.4% | Price Momentum | -1.5% | Profit Trends | 2.2% |
| Relative Valuation | -5.3% | Sales Acceleration | -2.4% | Earnings Growth | -12.1% |
| **Earnings Momentum** | **-5.9%** | **Earnings Momentum** | **-3.7%** | Relative Valuation | -14.1% |
| **Historic Growth** | **-7.3%** | **Historic Growth** | **-4.8%** | **Valuation** | **-18.2%** |
| **Profit Trends** | **-7.8%** | **Forecast Growth** | **-5.6%** | | |
| **Forecast Growth** | **-9.5%** | **Profit Trends** | **-5.6%** | | |

Source: Credit Suisse Russell 1000 universe

## The Portfolio Today

So what lies ahead? Well, even the most hardened observer would accept that September was an unusual month for the capital markets; some reversion to norms can be expected ahead. The question though is when; when does a level of normalcy return to the capital formation process? Further, with every manager that has had a tough time of it now asserting his portfolio is poised to rebound (even if he has meaningfully "de-risked" it) how are investors expected to sort out who is well positioned for what might lie ahead and who is not? Well, not surprisingly, we do not have any profound insight as to the "when" capital markets will turn. Indeed, our guess is vast swaths of the previous market regime (e.g. heavily structured products) may never return. What we do have though is an abundance of detail and insight into the financial characteristics of our portfolio that hopefully offers a good sense of its inherent attractiveness. What I offer below then is a headline look at the valuation, growth, earnings outlook and ultimately the risk/reward metrics we see in the portfolio. It is worth noting that while each company is analyzed on a bottom up basis, we are doing so with the understanding that the global economy has already entered a grim recessionary period akin to those of the 90's and 80's rather than the more shallow post tech bubble recession of 2001-2002.

Exhibit 5 provides the summary of the relevant financial attributions of our portfolio today. As you will note, at about 12x earnings our longs are trading at roughly one third the earnings growth rate we forecast for 2009, while our shorts trade at approximately 16x times earnings (which, in aggregate, we do not expect to grow at all in the year ahead). Further, we expect our longs to beat consensus forecasts by roughly 22% while we expect our shorts to fall shy of consensus by 15%. Lastly, if we go position by position based on current weightings in the portfolio we see potential upside to our longs of almost 70 percent, while downside to our shorts of roughly 30 percent. In essence then, we see a 100% expected return in the portfolio. Now to be clear on this last point, this is an exercise we always ask our sector teams to do and is by definition subjective and fraught with uncertainty. Along the way there will be errors in forecasts, multiples not achieved and so forth. To provide some context though, the upside we see to our longs is more than three times the hurdle rate we normally require to include a name in the portfolio, while the downside to our shorts is roughly twice the relevant hurdle we apply there. According to Lee, in our fifteen year history we have never had such a wide gap between what we view as fair value for our portfolio and how the market is ascribing fair value.

**Exhibit 5**

| | EV/ Sales | EV/ EBITDA | FCF Yield | 2008 P/E (Mav) | 2009 P/E (Mav) | Exp 3 Yr EPS Gr | 1 Yr Mav EPS Growth | '09 Delta w/ Cons |
|---|---|---|---|---|---|---|---|---|
| Longs | 2.4 | 8.4 | 7.2% | 15.2 | 11.7 | 21% | 30% | 22% |
| Shorts | 2.1 | 8.4 | 6.0% | 16.1 | 16.1 | 5% | 0% | -15% |

This episode marks the fifth financial rout I have lived through. Each has had its own character with the main commonality being that the problems of the time seem completely unsolvable. If anything, this convulsion is scarier because I actually know some of the players on the stage trying to navigate their companies or the economy through the crises. On a derivation of the Groucho Marx line, any club that would have acquaintances of mine as members should not be trying to save the world from economic catastrophe. Despite holding real concern that the economy is now deteriorating to match the ugliness in the financial markets, history suggests that the actual onset of recession is often required before investors can start thinking about the other side of the economic cycle and begin to focus once again on fundamentals. While September brought surreal irrationality in price moves across our portfolio, in my mind it also signaled clearly that we are in a global recession. Ironically then, while the carnage in the past month has been painful, I suspect the realization that recession is at hand will bring a return to analytical rationality. If it does, given the imbedded spreads in intrinsic value that exist between our longs and shorts today, the months ahead will go a long way towards filling the hole we dug in September.