SELLERS CAPITAL LLC
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October 14, 2008

Dear Partners:

Below are the results of the Sellers Capital Fund since its inception on August 1, 2003. Also shown are the returns of the three major market indices:

The Sellers Capital Fund
Returns Since Inception (8/1/03)

	Q3 2008	YTD	Total Return Since Inception	Annualized Return Since Inception
Sellers Capital Fund--Gross	-54.46%	-24.46%	211.22%	24.58%
Sellers Capital Fund--Net	-49.96%	-24.46%	154.98%	19.86%
S&P 500	-8.55%	-19.33%	29.72%	5.16%
Nasdaq	-9.16%	-21.41%	20.12%	3.61%
Dow Jones Industrials	-3.82%	-16.47%	29.34%	5.11%

Data through September 30, 2008. Returns are audited through December 31, 2007.
All returns include dividends.

Here are the quarterly net (after all fees) returns to partners since inception:

Sellers Capital Fund
Quarterly Net Returns

	Sellers Capital Fund	S&P 500
Q3 03	0.97%	0.87%
Q4 03	10.04%	12.18%
Q1 04	17.98%	1.70%
Q2 04	15.92%	1.71%
Q3 04	-17.47%	-1.87%
Q4 04	7.46%	9.23%
Q1 05	5.42%	-2.15%
Q2 05	11.57%	1.36%
Q3 05	5.97%	3.61%
Q4 05	13.23%	2.09%
Q1 06	-2.23%	4.21%
Q2 06	-9.97%	-1.44%
Q3 06	10.67%	5.67%
Q4 06	21.00%	6.70%
Q1 07	-8.57%	0.65%
Q2 07	46.89%	6.12%
Q3 07	-13.40%	2.46%
Q4 07	30.05%	-3.37%
Q1 08	18.58%	-9.47%
Q2 08	27.32%	-2.78%
Q3 08	-49.96%	-8.55%

*Third quarter 2003 results reflect only two months of performance.

And here are the annual returns of the fund since inception:

Sellers Capital Fund
Annual Gross and Net Returns

	Sellers Capital Fund (Gross)	Sellers Capital Fund (Net)	S&P 500 Index
2003	11.37%	11.37%	13.15%
2004	21.29%	21.29%	10.87%
2005	53.16%	41.13%	4.92%
2006	21.80%	17.20%	15.90%
2007	64.07%	51.25%	5.49%
2008	-24.46%	-24.46%	-19.33%
Annualized	**24.58%**	**19.86%**	**5.16%**

* 2003 results are partial year from August 1 to December 31
*** Net and Gross returns the same in 2003 and 2004 because no fees were charged to investors those years.

Third Quarter 2008
Before I talk about the third quarter, I'll answer a question I know some of you are going to ask me: How are we doing in October? We're down about 5% since October 1. And with that out of the way…

In my letter last quarter, I wrote that:

> The performance of the fund for the trailing twelve months through June 30, 2008 is approximately 88% before fees and 70% after fees. There is no way these kinds of returns will continue, and we're probably due for a mean reversion of some sort.

So I'm not surprised at all about the direction the fund took during the third quarter. We were due for a mean reversion. I am, however, *very* surprised about the extent and rapidity with which it happened. Talk about a mean reversion (in more ways than one!)

After this quarter's performance, the fund is still ahead of the broader market by about 20% annually since inception. I realize that's little consolation for those who have added capital to the fund this year.

Pollyanna
In 1913, Eleanor Porter wrote a book called *Pollyanna.* The book was about an orphaned girl who refused to let life get her down even though she had reason to. She played a game her father taught her called The Glad Game which entailed looking for the good in every situation, even (and maybe especially) if something seemed very bad on the surface.

There are a few good things to come out of the current situation we're in. Let's play The Glad Game for a minute.

1. **Contango is repurchasing shares at these prices.** Although Sellers Capital isn't buying the stock, Contango itself is, and that will have the same effect in the long run. The fewer shares outstanding, the higher our percentage ownership of the firm, and thus, the more of the underlying natural gas and oil reserves we own. If the company buys back 10% of its shares, our ownership goes from 15.8% to 17.5%. This is the same as if we bought 315,000 shares on the open market at current prices. The company is essentially averaging down for us, and for all other shareholders, too. So in this respect, the price decline is a good thing. This should have a positive effect on the ultimate price at which the company is sold (it's still up for sale).

2. **We have very little permanent capital impairment.** Even though the prices of our two stocks have declined precipitously in the past few months, we have only sold a small portion of our shares. We did lose some money liquidating the rest of the portfolio, but because those stocks were liquid large cap stocks and we had hedged them, the losses were minimal.

   So, for the most part we don't have losses we can't recoup.

To be clear, I strongly believe that holding onto a bad investment just to "get back to even" is a loser's game. If you realize something is a bad investment, you should sell it at the first opportunity. But that's not the situation we're in.

A bad investment is one in which the underlying fundamentals are worse than you thought when you made the investment. You made a mistake buying the stock in the first place. When you realize you have made a mistake, and you continue to hold on anyway, you are compounding one mistake with another.

But that's not the situation we're in. Nothing has changed with either of our holdings except their market prices. I believe we stand a good chance of getting back to the peak level of June 30, though the timing is difficult to predict.

3. **We didn't buy any banks or mortgage-related stocks, or any companies in financial distress.** This goes back to permanent capital impairment. If a company doesn't have any debt, or has so little debt that it can easily pay it off even in a severe recession, then it can't go bankrupt. And if a company can't go bankrupt, its stock can't go to zero. We haven't had any zeros since the inception of the fund (though we're wrong sometimes with our stock picks--we certainly aren't perfect!).

4. **We're still doing well on both a relative and absolute basis over the trailing 12 months.** We're down 1.8% net over the trailing four quarters through September 30. This is the first time we've ever been down over any rolling four-quarter period and I'm not happy about it. But things could be worse, given what the market has done over the same period. Again, I know this isn't much consolation to those who came into the fund recently.

5. **We probably won't have to pay any capital gains taxes this year.** If Contango had been sold in September, as planned, we would have had huge long-term capital gains this year and would have to pay a lot of taxes as a result. At this point, it doesn't look like we'll have much, if any, realized capital gains in 2008. The deferred sale allows us to wait an extra year or two to pay Uncle Sam. Waiting to pay taxes is like getting an interest-free loan from the government--we have to pay taxes on our gains but not until we sell. In the meantime, we can use the government's money to remain invested in stocks. I know this is a small consolation to those of you whose account is under water.

6. **We have patient, rational, supportive investors**. To generate good performance over long periods of time, an investment fund needs two things: A talented manager, and rational investors.

   Obviously, no investment fund can produce good long-term results without a talented manager. But manager talent isn't the only important thing when looking at a fund. Another important factor is the investor base. This aspect is often overlooked, but it's vital to how a fund performs--especially in times of stress.

   If you put a great manager in charge of a fund with irrational, skittish, flighty investors, the investor base will overwhelm even the most Herculean efforts of a good manager. Flighty investors get nervous, pull money out at the wrong times, and lock in losses. They force a manager to sell when he should be buying. When a good manager has money yanked away from him just as the market is getting really cheap, it hurts everyone in the fund, even the rational investors who stay put.

Throughout the last month, I have been reminded all over again how great the Sellers Capital investor base is. Our investors are a source of competitive advantage for us and this is one reason we've been able to generate such good performance over the years. I have talked to most of you on the phone and the vast majority of you have been supportive of the decisions I've made to protect our capital during this crisis. Most of you have stated that you're quite willing to ride out the storm.

I should have foreseen the worst-case scenario that is now occurring and prepared better for it, and I'm truly sorry that I did not.

But given the situation we're in, the most logical course of action was to take extreme measures to protect our capital. Nearly all of you seem to understand this and agree with it. We have a rational base of investors, and for that I am grateful. Your patience will help us get through a time when many other investment funds are selling to meet redemptions and locking in losses.

Fight or Flight

As I finish writing this letter, the market has just bounced 15% in the last 1½ trading days. But it's still down 30% for the year to date and there is probably still a lot of upside if you don't mind jumping on the roller coaster.

Whenever the stock market is the subject of newspaper front-pages, something very bad must be happening. Newspapers only run front-page stories on the stock market when something bad happens. The rest of the time the market is too boring for most people to care about.

Typically this is a contrary indicator. It doesn't mean we're at a bottom, but it means we may not have much further down to go. There is no person left in the United States, and possibly the entire Western world, that is not scared at the thought of putting money into the stock market.

When people are scared they react with emotion, making decisions that resemble a fight-or-flight response. Since there's no way to "fight" the stock market, that leaves "flight."

What we're seeing now is an adrenaline-fueled flight from the market. Last week alone, more than $40 billion was pulled out of U.S. equity mutual funds *after* the market was down 40% year-over-year. Many of those same people were, no doubt, pouring money into the market a year ago without thinking much about it.

Doomsday

Once in a great while, a flight from the stock market is rational. If you had sold all your stocks after the market crashed in October 1929, you may have felt like you were selling at the bottom…but you'd have saved yourself from losing another 60% over the next few years.

If a worst-case scenario plays out, anyone selling stocks now would probably be happy he sold, even at these low prices. Stocks will get a lot cheaper if the worst-case scenario comes to pass.

I think it's unlikely that this will happen because we've learned a lot about monetary policy and how to fix a broken economy in the 70 years since the last depression. For example, in the 1930s when banks were failing, the government actually *raised* interest rates for a while, thinking that would help.

But let's assume I'm wrong and things get really bad. Here's how it might play out.

Another major bank fails. This bank has a large book of derivatives which it defaults on. The bank has counterparties all over the world that now have a liquidity issue and/or large losses which now need to be written down. Many of these counterparties are levered because they're banks--all banks are levered--or energy firms that hedge production using derivatives, i.e. Chesapeake Energy (Note: Contango doesn't have any hedges so doesn't have this risk).

When these firms are forced to take write-offs because a counterparty went bankrupt, they deplete their book value (their equity). If they're banks, that means they will be deficient in their minimum regulatory capitalization requirements. They then risk bankruptcy themselves because the regulators will come in and shut them down for having too little equity. This means defaulting on their own derivatives, and all of a sudden everyone is defaulting, everyone has to write off huge amounts of capital because of derivative losses. Many, many banks are suddenly deficient in their regulatory capital requirements and are on the brink of bankruptcy. Some energy companies would also probably fail.

Let's forget about the energy companies for the time being and focus on the banks, which play a larger role in the health of the world economy. We need to save them first and worry about the energy companies later.

There are too many banks for the government to save individually. At first, the government doesn't realize this, and tries to save a few, but then gives up and lets a couple of banks go kaput before realizing the error of its ways (Lehman, anyone?). The government, in a panic, tries to create an all-encompassing plan to help, but political bickering, special interests, lack of understanding among the general public, misguided headlines calling it a Wall Street bailout rather than what it really is (an emergency backstop to forestall Great Depression II), moral hazard, and a poor understanding of how the banking system affects the world economy all prevent politicians from coming up with a realistic plan in time to stave off these bankruptcies.

In the meantime, investors in mutual funds and hedge funds panic and redeem their capital, forcing these funds to sell stocks. The government tries to prevent the selling by instituting a ban on short-selling all financial stocks (and a few non-financial stocks that somehow mysteriously get on the list). This causes hedge funds that were previously hedged to be unhedged at the worst possible time, and suddenly, market-neutral hedge funds are down 50% and their investors are running for the exits, causing panic selling among all types of stocks, not just financials. The short-selling ban has the opposite effect it was supposed to.

Of course, just the possibility of this happening causes brokers to stop lending to hedge funds or pretty much anyone else. Margin calls ensue. Hedge funds implode and Wall Street lays off tens of thousands of people. All of a sudden there are a lot of really well-educated MBA-types working at trendy New York restaurants. The New York real estate market craters.

CEOs of public companies also get margin calls because they bought their own stock using margin debt.

But the most serious effects are felt on Main Street, rather than Wall Street.

Banks are hoarding capital, so small businesses can't get lines of credit or working capital lines, so they can't grow. They stop hiring and many go out of business. Unemployed people, typically the most common form of entrepreneur, can't start businesses because they too can't get loans or investment capital (remember, the investors are running in panic, so they aren't going to invest in some startup. They won't invest in Berkshire Hathaway at a time like this, why would they invest in mom and pop?).

The unemployment rate jumps to 12% and people stop buying things. Retail stores close underperforming stores and lay off employees. This causes commercial real estate values to plummet as vacancies skyrocket. For every new retail store, two real estate brokerage offices close shop (did anyone else notice the glut of retail real estate offices that popped up during the bubble?). Derivatives based on commercial real estate loans fall further in value, exacerbating the derivative problem. Uh oh, who would have guessed, commercial real estate is not immune to all this! Oh crap! SELL EVERYTHING NOW! More bank write-offs ensue and banks have a new reason not to trust each other.

Residential real estate is not exactly turning the corner while all this is going on. People are out of work, not buying anything, hoarding cash, not able to sell their homes because they no longer have any home equity. They can't buy a new house because they have no down payment and the banks aren't doing zero-down no-doc liar loans anymore.

Making matters worse, the people who have their homes repossessed now have bad credit. They will have bad credit for years. Their FICO score goes from 800 to 600 in one fell swoop. These people who were naïve enough to think they could pay off any loan they could qualify for are effectively out of the mortgage market for several years, making it more difficult for the glut of unsold homes to be liquidated (the banks are actually checking credit these days, remember.) The old 2001 to mid-2007 way of doing business now seems like a dream. Banks are back to not trusting anyone. They don't even trust other banks; why should they trust homeowners?

The government pumps the economy full of money, so paper money is worth less, though perhaps not entirely worthless. Commodities rise to new highs because they represent tangible stores of value in a world where paper money is losing value. Stocks go to a P/E of 7 because of high oil prices and stagflation.

Oil is soaring because paper money is falling in value and because we have reached peak oil so wars are going to break out over oil. Everyone wants to secure their oil supply in the name of "national security" because the low-hanging fruit has been plucked. In the U.S., there's not enough bank credit to drill, baby, drill because many of the banks are bankrupt and the remaining ones are scared to lend, and to drill, baby, drill you have to have capital, and no one has much capital except the large E&P companies that have legacy reserves like Exxon and Chevron. The smaller oil companies don't have the capital to drill. Countries begin to look jealously at others who are oil-rich and wars break out in the name of securing supplies. These wars threaten to cut off supply, imbedding a large risk premium into oil prices.

People stop buying cars for two reasons. One, as oil prices rise, so do gas prices. Two, CarMax and GMAC aren't lending to buyers because they can't securitize the loans they write because investors aren't buying securitized loans because investors don't trust that the borrowers were properly checked out before being approved for the loan. No one trusts anyone anymore. Investors in mortgage securitization pools got burned badly and they aren't about to be suckered again anytime soon, whether it's auto loans or home loans or credit card loans or whatever.

GM and/or Ford go bankrupt because fewer people are going to buy a truck or SUV with $5 gas prices and the companies can't afford the upfront costs to re-engineer in order to mass produce fuel-efficient cars. They each lay off 50,000 people in Ohio, Indiana, and Michigan. Chrysler also lays off people. 125,000 people now can't pay their mortgages because they have no union job that lets them work 70 hours a week and book much of it as double-pay overtime, and so they begin looking for jobs in the oil and gas industry in Texas and Louisiana. Detroit becomes a ghost town (last one to leave please turn out the lights!) just like Benton Harbor did after Whirlpool closed its manufacturing plant a couple decades ago (today in Benton Harbor, 33% of the residents have incomes less than $10,000 and more than 50% are unemployed). The whole state of Michigan implodes, with unemployment rising to 25%. The Midwest housing market gets worse (is that even possible?) as banks repossess thousands of homes and dump them on the market at lower and lower prices. Riots ensue, crime rates go through the roof, and the National Guard is called in.

The airlines mostly go broke because of high oil prices. The few that survive charge $2,500 for a roundtrip coach ticket from Miami to New York, so very few people can afford to fly. Cars are also too expensive for a lot of people to drive given gas prices. Trains become a lot more popular, but the tracks are slow and the trains break down a lot. Business travel dries up and teleconferencing becomes more popular...

The Value of Trust

I could go on but you get the gist. Do I think this scenario will happen? It already has, partially. We're about half way there, I'd say. I don't think we'll go all the way there because I think we have the ability, and the will, to get out of this crisis before it gets worse.

The way to do it is to restore trust, because the key element of the credit crunch is a lack of trust. No one trusts anyone in the capital markets right now, so they won't lend to anyone, so the credit markets have seized up. Until banks and investors trust that they can get their money back if they lend it out, the credit markets will remain seized.

The regulators should make a strong point to ensure that financial firms write down the value of their toxic mortgage investments as soon as possible. The banks should not be allowed to dribble out the write-offs over long periods of time. They need to do it all at once, by a certain date that isn't too far in the future.

If the banks write down these toxic assets all in one big fell swoop, rather than dribbling them out as they have been and lying about the ultimate extent of the problem, the skeletons in the closet will be gone. But they're going to need equity to replace the capital that was just written off. If they can't get this equity, they'll go bankrupt immediately.

As American taxpayers, we can make a huge profit on this situation by purchasing new equity in these banks in the same amount as the writeoffs. By helping the banks, we help ourselves. This may be one of the first situations I can think of where Ayn Rand and Carl Marx would agree. It's capitalism and socialism all rolled into one. Kind of like Canada. Or maybe Sweden.

If we do this, the banks will be adequately capitalized and they can start to trust each other again. When the banks trust each other, they'll be willing to lend to each other and money will flow freely through the economy rather than being hoarded. The economy will get back on its feet, stock prices will go up, and the government can slowly sell off the equity it has purchased and make a profit or at the very least, break even.

The cost to the American taxpayers: $0, at worst. At best, the profit will be hundreds of billions of dollars.

It won't work unless regulators and auditors get tough and force financial firms to take their medicine quickly, rather than continuing to obfuscate the truth and then surprise investors later with negative announcements of additional write-offs.

We have no choice. If we don't restore trust in the credit markets, we're in really big trouble.

Pollyanna, or Doomsday?

In my opinion, this is an ok time to buy stocks, but not a great time, especially with the market 15% higher today than it was two days ago. If the government's plan is not carried out properly, if trust isn't restored, the current situation we're in will get worse. Still, a lot of that is probably factored into stock prices at this point. The volatility index (VIX) is still at multi-year highs, still higher than it was in 2002 during the worst part of the bear market. The year-to-date loss on stocks is still more than 30%, even after the rally of the last couple days, and stocks weren't exactly at bubble levels before. Real estate values were, but not stock values. So valuation is on your side.

But as we've seen recently, valuation doesn't mean much in the short-term. What means more in the short term is the direction of analyst earnings estimates, and those don't look pretty. Estimates continue to go down across the board, and this will provide a headwind to rising stock prices. Stocks rarely go up while earnings estimates are falling. This is true on an individual stock level, and on a market-wide level. It could be a while before estimates bottom out.

So which way will the market go? I have no idea. There are positives (valuation) and negatives (falling estimates.) These two factors may offset each other, such that the market just kind of hangs around at these levels, bouncing around in a range, for some time.

When the economy starts to turn around, there will be lots of upside to stocks. Until then, keep some dry powder and wait for trust to return. Humans are trusting of one another, by nature. Sometimes we have this beaten out of us and it takes a while to forget the past, but as a species, we generally trust one another except in extreme circumstances. Trust in the credit markets will return eventually, and whenever that happens, the economy will begin to heal, and you can bet stocks will go to much higher levels than they are today.

As always, please feel free to call or e-mail me with any questions or comments you have. Given what has transpired in the past couple of months, I'm happy to talk to anyone, anytime, about the markets or whatever else you want to talk about.

Sincerely,

Mark Sellers III