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What a difference a year makes. Last year at this time, the capital markets were in turmoil, the economy was deep in recession, our banking system appeared broken, and investors were consumed with fear. However, as the year progressed, the economy began to show signs of life in response to aggressive fiscal and monetary stimulus and unprecedented government intervention to save our failing banks. After starting the year with further declines, the stock market and credit markets began a ferocious rally in March that continued throughout the year. For the full year, the S&P 500 Index posted a total return of 26.5%, its best showing since 2003. Foreign stocks, as represented by the MSCI EAFE Index, posted even higher returns of 32.4%, thanks, in part, to a weak U.S. dollar. Bonds also generated impressive gains for the year. The Barclays Aggregate Bond Index rose only 5.9% due to its large exposure to U.S. Treasuries that entered the year very overvalued and over-owned. Investment-grade corporate bonds, though, delivered nearly 20% returns and high-yield bonds returned in excess of 40%.

Last year at this time, we wrote that “when we look back on this period ten years from now, it will be clear that this was an obvious time to take advantage of depressed prices and investor pessimism.” Despite our skepticism of a strong economic recovery, we initiated numerous new opportunistic investments. We entered the year with our tax-deferred retirement accounts strongly positioned for a recovery in investment grade corporate bonds. In January for both taxable and tax-deferred accounts, we initiated investments in emerging market stocks, commodities and Treasury Inflation Protected Securities. At the March market lows, we increased our U.S. stock market exposure significantly with the purchase of depressed equity funds. Then as the stock market rally matured, we continued to add market exposure with more “defensive” equity funds that had lagged the advance. Thanks to our opportunistic purchases, our portfolios, generally speaking, performed very well – well in excess of portfolios with similar objectives. Even more importantly, in the preceding year we were similarly successful in limiting our losses in what was a near disaster for most investors. We take great pride in our investment success over the last two turbulent years.

Looking forward, we cannot help but be guarded in our optimism. The capital markets appear to be overly enthusiastic regarding the prospects for the economy. The stock market is now once again very expensive unless one accepts the most optimistic of

economic forecasts. We believe that the state of the economy remains fragile and that signs of weakness will soon reappear. Even looking out a few years our economy faces a difficult road ahead as it attempts to correct extreme indebtedness. We believe that the government will be forced to continue its aggressive fiscal and monetary stimulus efforts, and even with such action, it could take years to re-ignite the American economic engine. At that point, years from now, we remain concerned that the stage will be set for a period of high inflation. We view this eventual outcome as likely given that only a sustained period of high inflation will allow our government to monetize its enormous debt.

As such, we are of the belief that this new decade will be characterized by deflation followed by inflation and will eventually favor “real assets.” In recent decades investors have only spoken in terms of “return.” In this new decade we will soon be talking of “real returns” or “returns after inflation.” We believe it will be a decade in which investors will eventually see the limitations of a traditional stock/bond portfolio’s ability to mitigate the erosive effects of rising prices, and it will be a decade that will require a more innovative approach to portfolio management - one that incorporates alternative investments, and real assets such as commodities to a much greater extent. While we believe the risks of inflation in the near term remain slight given the slack in the economy and a still hobbled credit system, it is our belief that inflation is nonetheless inevitable. It will be our goal in the coming years to properly position our portfolios to maintain their purchasing power in just such an environment.

Over the past twelve years, we have successfully navigated our portfolios through all sorts of investment environments, both good and bad. We are confident that our flexible and diversified portfolios combined with our contrarian, forward thinking investment philosophy will continue to serve us well.

Sincerely,

A handwritten signature in black ink, appearing to read "David B. Ackerman". The signature is fluid and cursive, with a long horizontal stroke at the end.

David B. Ackerman, CFA, CFP