Knightsbridge Asset Management
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FIRST QUARTER COMMENTARY

"There can be few fields of human endeavor in which history accounts for so little as in the world of finance. Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present."

John Kenneth Galbraith, 1908-
Professor Emeritus, Economics,
Harvard University
1949-1995
A Short History of Financial Euphoria

The ongoing bull market is unquestionably one of the "incredible wonders of the present" to which Dr. Galbraith so eloquently refers. In our own version of the mad cow disease, the mad bull-market disease has us all in its grip, and bearish views have increasingly lost credibility. Anyone counseling caution is dismissed as either unintelligent or simply misinformed regarding prospects in this new age. So be it. Those antediluvian thinkers hobbled by "memory" and "experience", present company not excepted, are doomed to continue believing that business cycles and bear markets are lurking somewhere out there in our future. The average IPO (initial public offering) is coming public at a price-earning ratio of 56. This is astounding… and compares to the market price-earnings ratio at 17 times trailing earnings. This statistic is but one

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measure of the current market environment and its extremes. Many are throwing caution to the wind, and a price will be paid somewhere down the road for this behavior.

The strong February and March jobs data caught the market by surprise, which reacted with hundred point losses on the Dow Jones Industrial Average and a 30 basis point rise in 30 year Treasury yields on the February data and another 20 basis point rise on the March data. The stock market's response initially was the greatest loss in one day in the past five (5) years. Since there has been only one decrease in the Federal Reserve discount rate since the weaker winter and Christmas season economic numbers, this raises a very important question… if the economy is now strengthening, as seems the case with corroborating data from March and April so far, how much room can the Fed have to lower rates further? Apparently not very much. If the economy is rolling along at a good clip by the third or fourth quarter, we may only have room for one more rate cut between now and then, if that. Aggravating the picture is an already aggressive Japanese reflation and the prospect Europe will be on the rebound at roughly the same time. Why is this important? Because it implies higher interest rates, and a probable end to the current bull market. Were this scenario to be accurate, one would expect the stock market to be discounting these events six (6) to twelve (12) months ahead. Which means we could be witnessing a market top if not right now, then certainly by mid-summer.

Reinforcing this market top idea is a simple observation that stems from a comparison of the Dow Jones Utility Average and the Dow Jones Transportation Average. It goes like this… the Utility Average leads the market as a whole on both the upside and the downside (see chart #1). The Transportation Average lags the market as a whole on both the upside and the downside. Therefore, at market tops we typically see the utilities getting slammed while the transports are punching through to new highs. Such is precisely the case at this point in time (see chart #2). Transport stocks have outperformed the S&P 500 during seven (7) of the last nine (9) bull market tops since 1960.

Moreover, the dividend yield on the S&P 500 continues to plumb for yet new lows (see chart #3) beyond century-old benchmarks which is past years were reliable indicators of a richly priced market. And then we have the ratio of bond yield to stock market yield (see chart #4). Notice when this indicator was last at these levels, we subsequently witnessed the carnage of the 1987 market. For these reasons and others we will be continuing to err on the side of caution by maintaining larger then normal cash equivalent reserves… 30% or so for most accounts… in the belief that these excesses will be correcting to provide for better valuations at a point in time in the not so distant future.

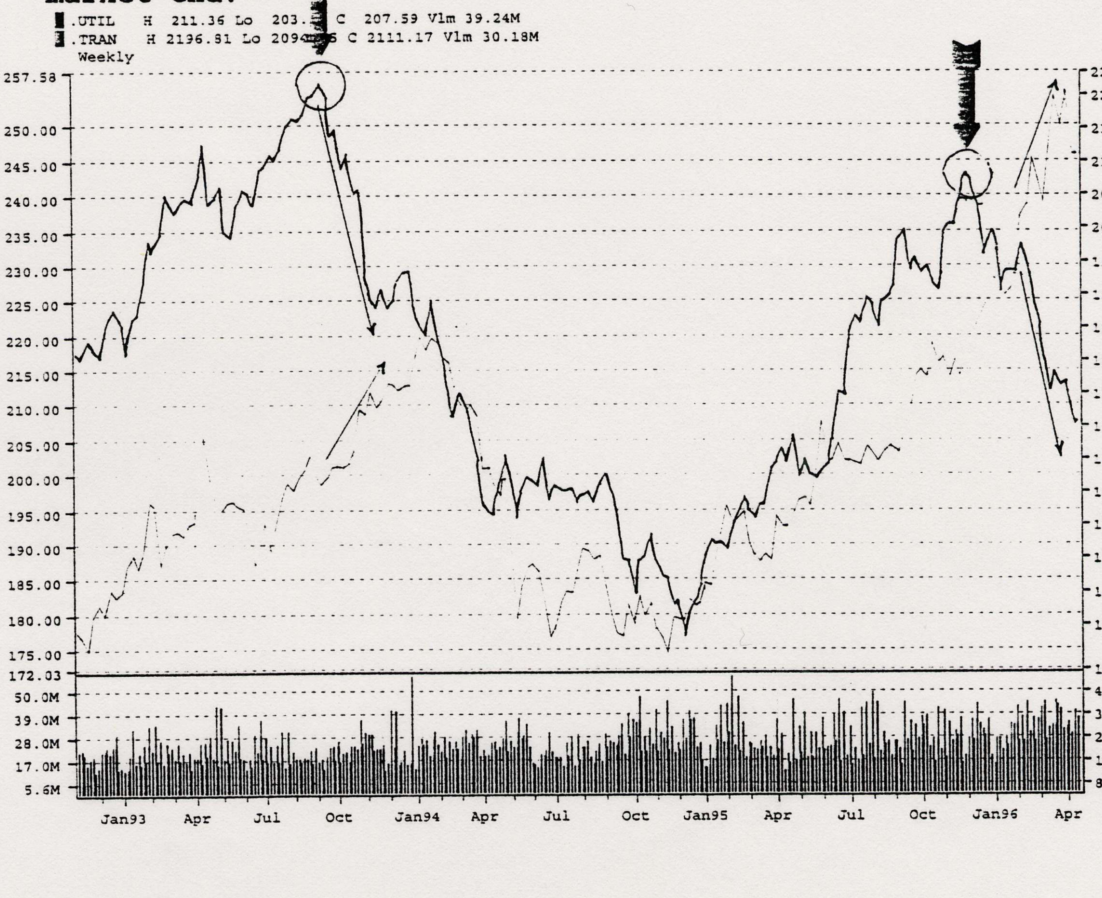
Although the experience of the past 25 years leads one to conclude that the current environment is fraught with risk, nevertheless, we must be absolutely self effacing concerning evidence to the contrary. Things are never clear-cut. For example, the Zweig index of technical indicators is still mildly positive. So too is the ratio of public short sales to total short sales, reflecting a market capable of moving yet higher. And these conflicting indicators add grist for the mill of market controversy. So as we consider Professor Galbraith's remarks, we observe that the current market environment provides ample proof for his incisive observations. In the meantime we thank you for your patience and forge ahead.

Sincerely,

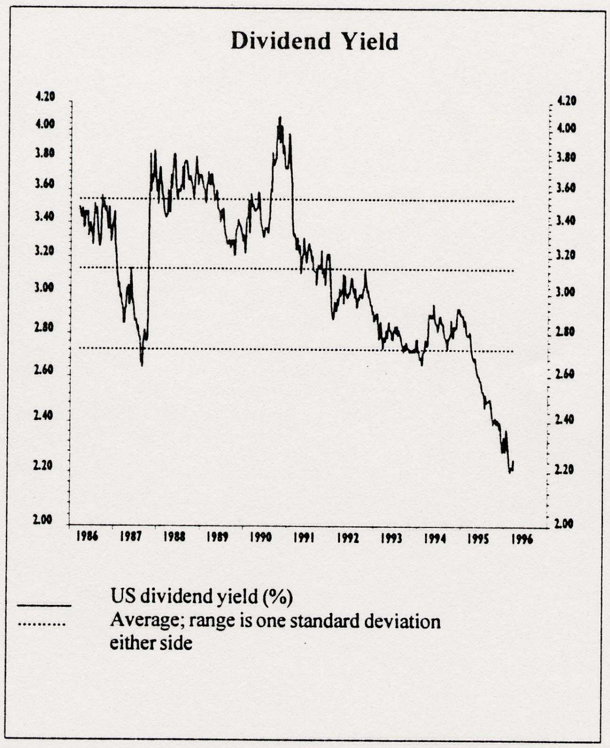
Alan T. Beimfohr

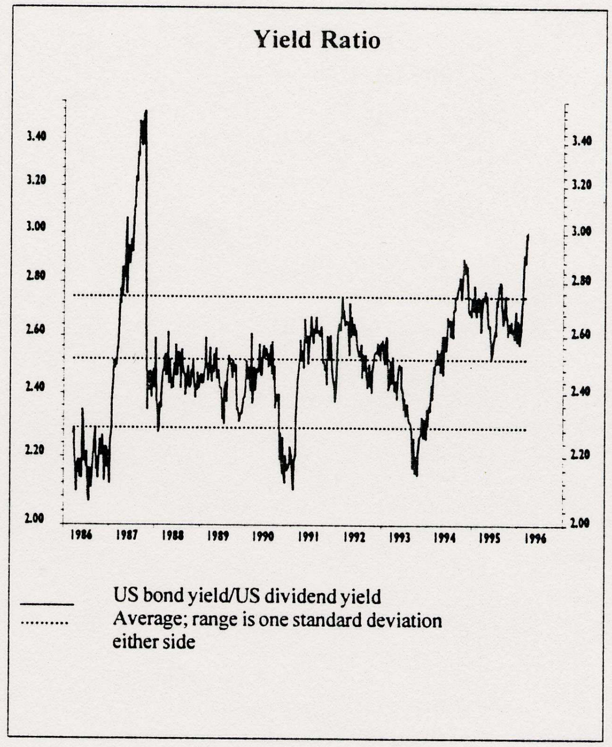
CHART # 1: Utilities tops lead market tops by about six (6) months.

CHART # 2: Utilities decline while Transports keep on going up for about six months... a possible precursor to the bull market end.



Equities and Market Valuation





Source: S&P 500 for dividend yield; Long bond yield for bond yield

CHART # 3

Dividend yields at new all-time lows

CHART # 4

Rising bond yields pushing ratio of bond yields to dividend yields into high and dangerous territory