Knightsbridge Asset Management, LLC

April 10, 2001

FIRST QUARTER COMMENTARY

"Many fail to grasp what they have seen, and cannot judge what they have learned, though they tell themselves they know."

-Heraclitus of Ephesus
Greek Philosopher, 535-475 B.C
On Nature,
translation from Fragments, The Collected Wisdom of Heraclitus
translated by Brooks Haxton

Heraclitus taught that there was no permanent reality except the reality of change. And change the markets have! With the evaporation of $5 trillion in market value, this bear market experience is a first for many. For perspective, $5 trillion is almost three times the federal government's annual expenditures. The last bear market, 1990, was a sub-par S&P 500 decline of 15% on the eve of the Persian Gulf War. In fact, the voracity of the current decline has not been matched since 1987, fourteen years ago. With the S&P down 30%, the broad based Wilshire 5000 down 32% and the NASDAQ 100 down 72% from March 2000 peaks to April 4th, few investors have been spared.

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The first quarter of 2001 was particularly nasty with a decline of 12% for the S&P 500, on top of fourth quarter's decline of 7.8%, adding insult to injury. Consensus estimates for S&P 500 earnings are for a first quarter decline of 8%, and for all of 2001, a decline of 5.3%. Moreover, of all recent earnings revisions made by Wall Street analysts, 80% have been downward.

After three successive reductions in interest rates by the Fed, the failure of the market to respond so far has observers rightfully worried. Portfolios have gone into a nose-dive and as one pundit so eloquently stated, "left investors clutching for their barf bags."

Let us look at the history of the so-called "bear market." There have been ten (10) bear markets since 1933, arbitrarily defined as a drop of at least 20% on the S&P 500. These drops have averaged:

1. **Sixteen (16) months in length**
2. **A drop of 32%, peak to trough**
3. **An average P/E contraction of 33% (last 7 bear markets)**

As of April 4th, we have experienced the following:

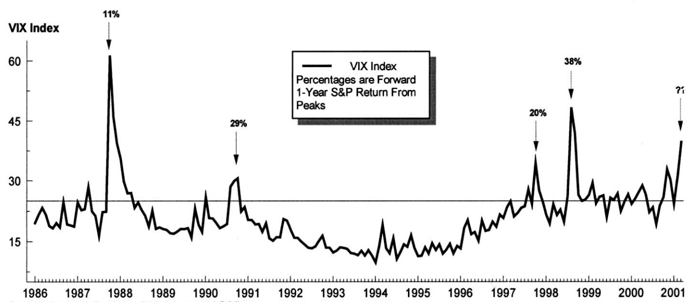
1. **Approaching thirteen (13) months in length**
2. **A drop of 30%, peak to trough (S&P 500 index, 1553 to 1081)**
3. **A P/E contraction of 35% (30x to 19.4x on year-forward estimates)**

Therefore, one must rightfully be wondering if the current bear market is over, or if not over, almost over. Of course, one must remember that "average declines" are just that… average. Some are more, some less. This one could be "more" especially because the valuation extremes from whence they came were just that… extreme. Mitigating against that is the Federal Reserve Board stance, and history suggests that fighting the Fed is a poor bet. But "fighting the tape" can also be a poor bet.

Among many factors, we are inclined to view the following as important in telling us if the bear market is over:

1. We have wanted to see a substantial contraction of margin debt on the order of 25% to 50%. We've reached a 33% contraction thru February, and undoubtedly more since that time. No bear market has ever ended without at least a 25% shrinkage in margin debt.

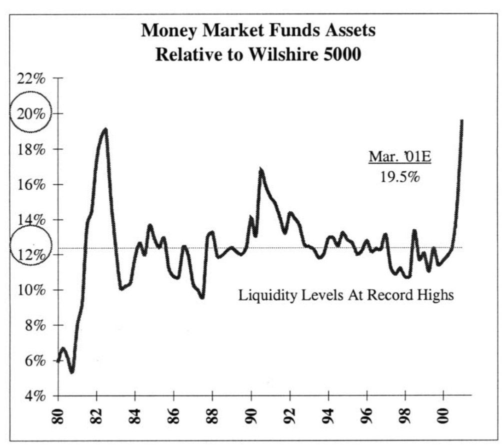
2. Volatility increases as markets decline. Important market bottoms are often identified with a spike in volatility. We wanted to see a volatility index (VIX) reading in the neighborhood of 40 to 50; we've reached 42 so far. As they say on the street, "when volatility is high, it's time to buy."



Source: Lehman Brothers, Bloomberg and S&P.

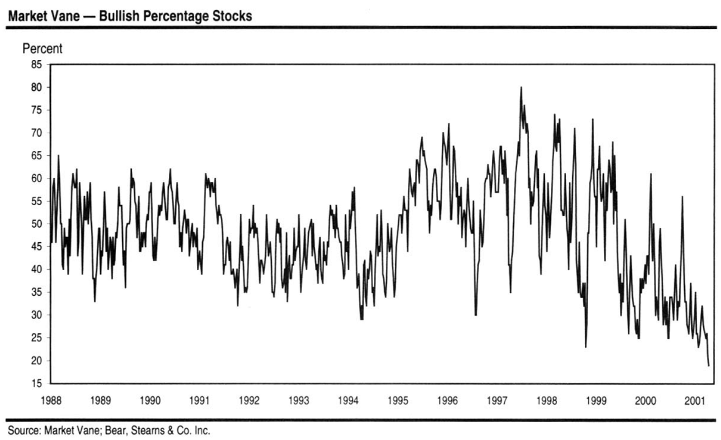
3. We wanted to see a put/call option ratio of extreme proportion indicating a capitulation and a peak in fear of further decline; it is currently somewhat extreme, but could be more extreme

4. Cash holdings have risen to a range consistent with other bear market bottoms. Specifically, we had wanted to see money market funds as a percentage of NYSE total values rise to 15%, a level not seen since the bear market of 1990. It has arrived as of March 31st. Additionally, money market fund holdings as a percent of the broad-based Wilshire 5000 are at 20-year highs.

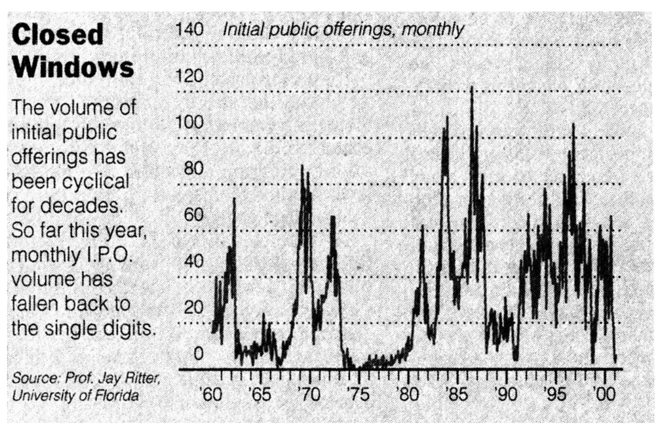


Source: Federal Reserve , ICI, and DRI/McGraw-Hill

5. We wanted to see advisory sentiment from the Investor Intelligence, Market Vane, and American Association of Individual Investors (AAII) surveys showing extreme levels of pessimism. With the exception of pessimism (see chart below), found below in the Market Vane survey, which may be attributable to it being derived from stock index futures which are market capitalization weighted, the other surveys are more neutral and therefore cause for caution.

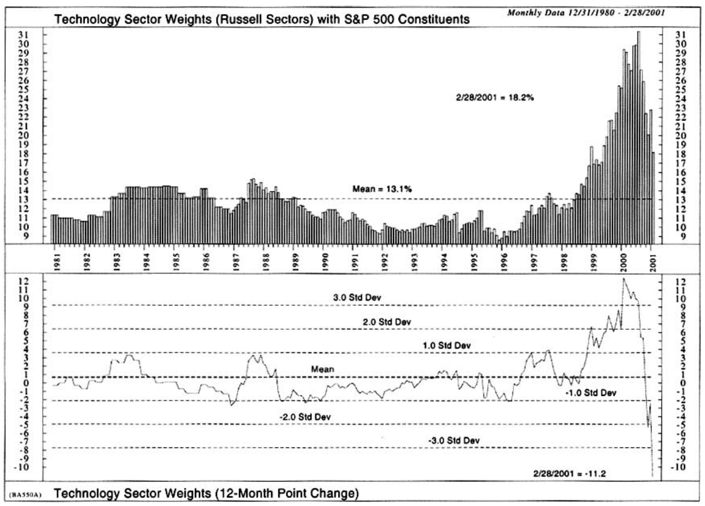


6. The IPO market in 1999 and early 2000 was the most visible manifestation of speculation run amok. We wanted to see a complete dry-up of the IPO market: in February of 2000 there were 55 IPO's, in February of 2001, 6… perhaps not a complete "dry-up", but close.



The New York Times

Moreover, the technology sector weighting dropped from a recent 31% of the S&P 500 to 18% by the end of February. In fact, technology stocks as a group have been superseded by financial stocks as a group at 19% of the S&P 500. While the technology weighting fell further in March to 17%, this is still above the historical average weighting of 13%. So although not yet in line with historical norms, we are not far away. Furthermore, technology sector weights which had risen so steeply in 1998, 1999 and early 2000 have now plunged even more rapidly than they rose. We view this catharsis as necessary to re-establishing the longer-term health of the overall market.



One might logically ask what evidence exists to believe that the upside rewards outweigh the downside risks. First, following a third rate cut (there were three in the first quarter alone), the evidence is encouraging. If we look at the S&P 500, we see the average decline from a 3rd rate cut is about 2% within a couple of months, and the average one-year-forward return from a 3rd rate cut is 24%. Pretty darn good odds.

Following a Third Fed Rate Cut, Negative Stock Market Returns Have Been Limited ...

3rd Fed Ease	S&P 500 Close	Low Over Next Year	Low Date	Days	Max Loss from 3rd Cut (%)
3/7/58	42	41	4/4/58	28	1
1/8/71	92	90	11/23/71	319	2
2/5/75	79	78	2/10/75	5	1
7/28/80	121	121	8/5/80	8	1
7/20/82	112	102	8/12/82	23	8
5/20/85	190	181	9/25/85	128	5
4/30/91	375	369	5/15/91	15	2
1/31/96	636	627	7/24/96	175	1
11/17/98	1139	1139	11/17/98	0	0
3/20/01	1143		???	???	???
Average				78	2
Median				23	1

Source: Lehman Brothers and Bloomberg

... While Forward-One-Year Returns Have Been Handsome

3rd Fed Ease	S&P 500 Close	3 Mos. Later	Return (%)	6 Mos. Later	Return (%)	12 Mos. Later	Return (%)
3/7/58	42	45	6	48	14	56	34
1/8/71	92	102	11	100	9	103	12
2/5/75	79	90	14	86	9	100	27
7/28/80	121	128	5	130	7	129	6
7/20/82	112	139	25	146	31	169	52
5/20/85	190	188	-1	199	5	236	24
4/30/91	375	387	3	393	5	415	11
1/31/96	636	654	3	640	1	786	24
11/17/98	1139	1224	7	1339	18	1411	24
3/20/01	1143		???	???	???	???	
Average			8		11		24
Median			6		9		24

Source: Lehman Brothers and Bloomberg

If instead, we look at NASDAQ, with more limited historical evidence (25 years), we still see average upside of 30% to 40% and downside of only 2% or so. Again, pretty good odds.

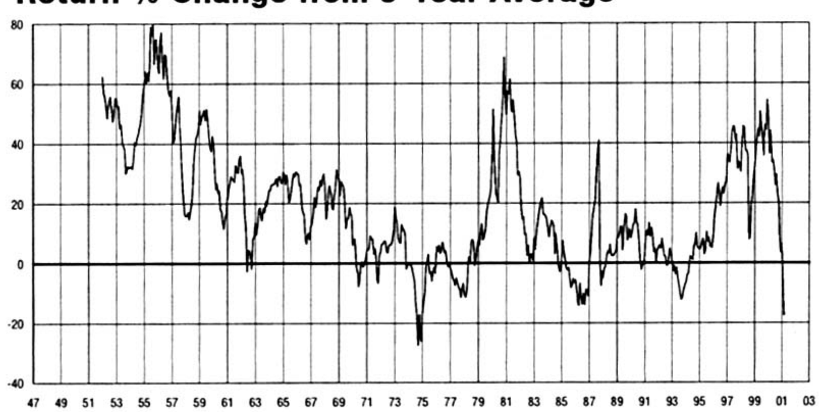
NASDAQ RISK/REWARD
FROM DATES OF THIRD RATE CUTS

Date of 3rd Cut	— For Subsequent 12 Months — Max. Gain from Cut Date	Max. Decline from Cut Date
02/05/1975	24.5%	-0.4%
07/28/1980	31.5%	0.0%
07/20/1982	92.6%	-6.9%
05/20/1985	33.2%	-6.0%
04/30/1991	33.1%	-2.4%
01/31/1996	31.0%	-1.6%
11/17/1998	75.4%	0.0%
Mean	**45.9%**	**-2.5%**
Median	**33.1%**	**-1.6%**
High	**92.6%**	**0.0%**
Low	**24.5%**	**-6.9%**

Maximum Gain/Decline based on highest and lowest NASDAQ close in the 12 months following the close on the dates listed. T_HOT10316_4

Moreover, if we were to measure the difference in performance between bonds (good performance) and stocks (poor performance) over the past year, and compare it to 5-year averages, we can see that this measure is at extreme lows, exceeded only once in 1974 (and what a bear market bottom that was!) since the calculations started in 1952!

S&P 500 vs. Long Treasury Bond — Relative Total Return % Change from 5-Year Average



Source: Salomon Smith Barney

Furthermore, if we look at subsequent S&P 500 performance for every 12-month time period wherein bonds outperformed stocks by at least 10%, we find once again that the average one-year-forward S&P 500 return is 24%. Looking at some of the economic fundamentals, there is no question that many of the numbers rolling in are dreary, with some downright scary. The problem we face in dealing with these numbers is that most are either coincident or lagging indicators, and as such, they now tell us why the stock markets were declining over the last two quarters, but are of little or no value in telling us what to expect from the stock market going forward. Just as the markets decline initially while fundamentals look good, so the markets rise initially as fundamentals still look bad. Stemming the tide will take heaps of liquidity, and so we look for corroborating evidence that the Fed is not just lowering interest rates, but that money growth is strong.

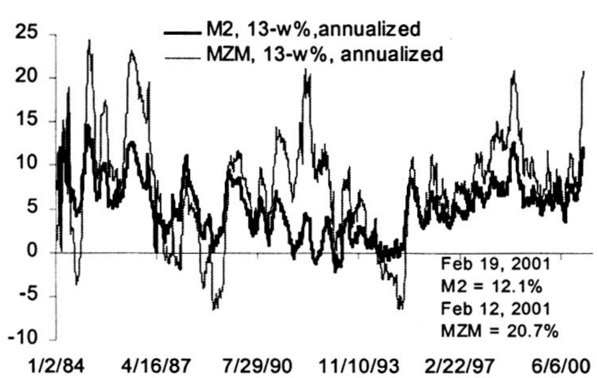
Subsequent S&P 500 Performance

	Stocks vs. Bonds 5-Yr Avg	S&P 500 Subsequent Return 6 Mo	12 Mo
09/1974	-27.4	34.45%	38.13%
12/1974	-26.1	41.83%	37.23%
11/1974	-24.2	33.28%	36.18%
08/1974	-17.6	16.04%	26.15%
10/1974	-17.2	20.98%	25.99%
01/1975	-17.1	17.73%	36.56%
03/2001	-17.6		
04/1986	-14.2	5.38%	26.51%
09/1986	-13.9	28.11%	43.42%
07/1986	-13.8	18.03%	39.29%
02/1975	-13.6	8.72%	27.28%
03/1986	-13.4	-1.49%	26.20%
07/1974	-12.2	-0.34%	17.33%
09/1993	-12.1	-1.55%	3.69%
10/1993	-11.7	-2.32%	3.86%
10/1977	-11.4	7.71%	6.34%
02/1978	-11.4	21.77%	16.63%
12/1986	-11.0	27.44%	5.25%
06/1986	-10.9	-1.79%	25.16%
08/1993	-10.5	2.14%	5.47%
08/1986	-10.2	14.22%	34.51%
01/1978	-10.1	15.82%	18.06%
	Average	14.58%	23.77%
	Max	41.83%	43.42%
	Min	-2.32%	3.69%
	Std. Dev.	13.36%	13.02%

Source: Salomon Smith Barney

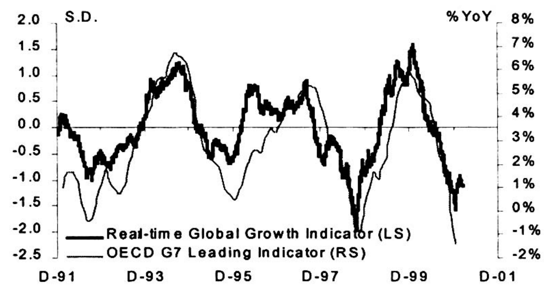
MZM refers to "money of zero maturity" and we can see that 13-week growth rates are at a 15 year high. Furthermore, global growth and global semiconductor earnings revisions are looking like a bottom has been reached. Bear in mind that the auto industry is the largest single consumer of semiconductors, and auto sales are relatively healthy having already adjusted for a fourth quarter inventory overhang.(see charts on next page)

US MZM and M2 Growth Close to Fifteen Year Peaks



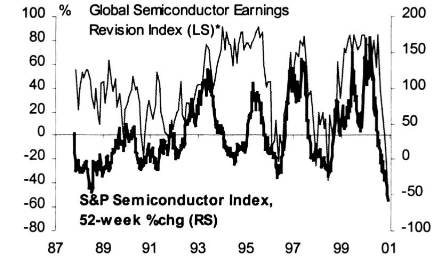
Source: Bloomberg, Federal Reserve Board

Our Real-time Global Growth Indicator Has Bottomed



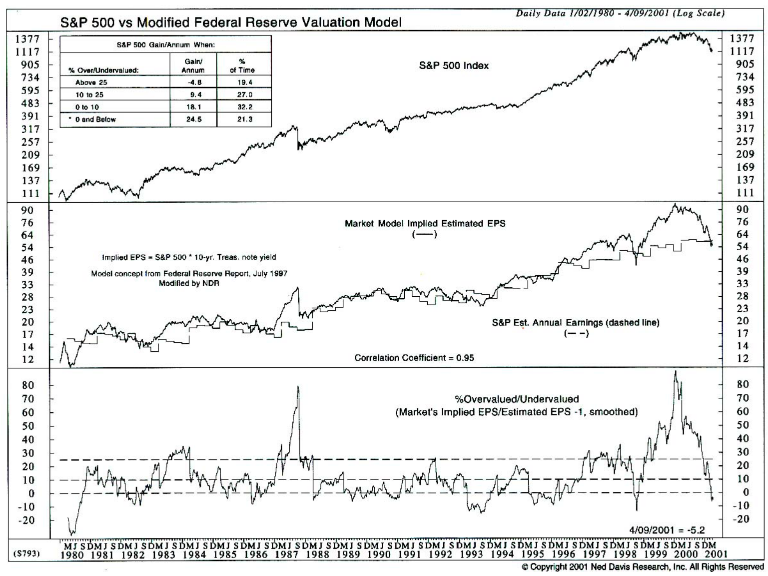
Source: Datastream, Morgan Stanley Dean Witter Research

Global Semiconductor Earnings Revisions At a Bottom

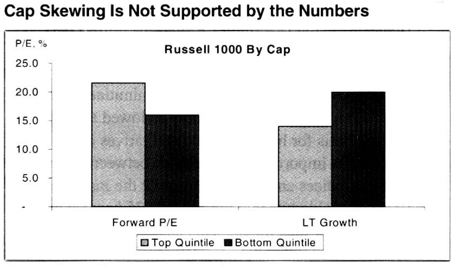


** Number of upward less downward over total revisions in rolling 12-mth forward EPS. Source: Datastream, Morgan Stanley Dean Witter Research*

If we look at the valuation model used by the Federal Reserve, we see that relative to interest rates, the S&P 500 is, in fact, undervalued. This is not to say that it can't stay undervalued a while or even become more undervalued, as it was in 1980. But nevertheless, the numbers are on the side of the stock market investor with average one-year ahead gains for the S&P 500 of 24%, once below the zero line.

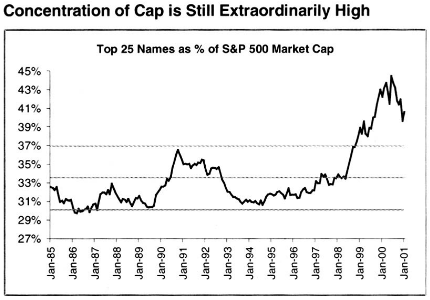


Cap Skewing Is Not Supported by the Numbers



Source: First Call, IBES, Morgan Stanley Dean Witter Research

Concentration of Cap is Still Extraordinarily High



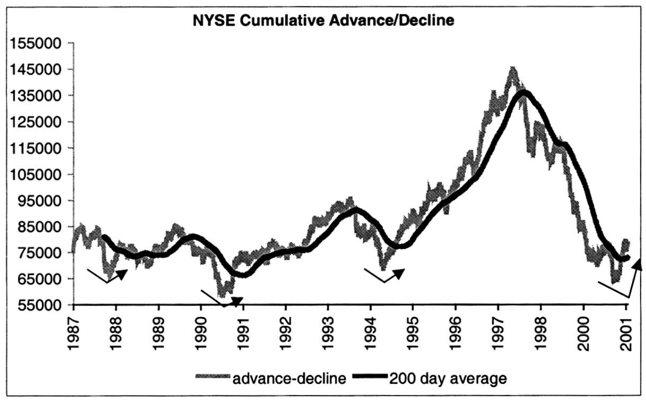
Source: Morgan Stanley Dean Witter Research

Lastly, we cannot ignore the fact that most of the smaller stocks are simply doing much better than the cap-weighted behemoths. We alluded to the overvaluation of the largest cap 100 within the S&P 500 in our last quarterly letter. We bring it up again because we feel this is where the greatest risk lies. After all, the median P/E of the S&P 500 is 16x trailing earnings which is certainly not excessive in the current interest rate environment. However, as can be seen in these charts and others, the mega-cap group within the S&P 500 is overvalued still.

We believe this is where the greatest risk lies in the current environment, and that although some premium might be warranted for size alone, the disparities are simply too great. Lastly, we cannot ignore the fact that the superior performance of smaller stocks has created a "breadth breakout" to the upside. While their mega-cap brethren get pounded, the smaller company stocks are quietly making their way upward amid the doom and gloom. This is very positive and cannot be ignored.

Periods of economic stress are often marked by a large bankruptcy such as Orange County following the unexpected rise in interest rates in 1993/4. Pacific Gas & Electric is the third largest corporate bankruptcy in history and we believe will mark the end of the bear market of 2000-1.

Upside Breakout for Breadth



And so 2500 years after Heraclitus reminded the world that the only reality was the reality of change, we once again wrestle with a market environment envisioned by no one a year ago, ourselves included, though pessimistic at the time. Although not all of the market's overvaluation has been worked through, we believe sufficient damage has been done to impel us to become substantially more positive, and we look for good and improved investment returns in the year ahead. We thank you for placing your trust in us and look forward to serving you in the intervening months.

Sincerely,

Alan T. Beimfohr John G. Prichard, CFA