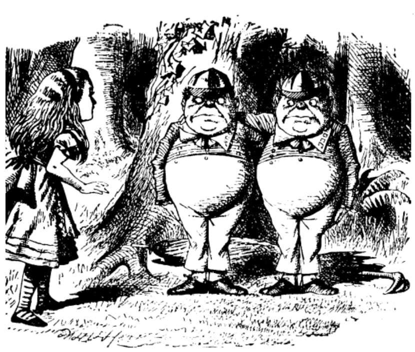
Knightsbridge Asset Management, LLC

July 31, 2001

SECOND QUARTER COMMENTARY

"Contrariwise," continued Tweedledee "if it was so, it might be; and if it were so, it would be; but as it isn't, it ain't. That's logic."

-Charles Lutwidge Dodgson,
AKA Lewis Carroll, 1832-1889
English writer and mathematician
Through the Looking-Glass, and What Alice Found There, 1872



Alice meets Tweedledum and Tweedledee

Failing to pay close attention, Tweedledee's comment could be mistaken for Greenspan Humphrey-Hawkins testimony on Capitol Hill. But we know better. Alan Greenspan never says 'ain't'. Nevertheless, there is a certain 'Alice in Wonderland' quality to recent economic events.

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Consider six (6) successive reductions in the Federal Reserve Discount Rate in six months. The most aggressive reductions in the Fed's eighty-eight year history were expected by market participants to produce a higher, not lower, stock market. They were expected to produce a weaker, not stronger, dollar currency. And eventually, with a six to nine month lag, they are expected to produce economic recovery. And so we await the expected outcomes for which there has been precious little evidence to date. The S&P 500, down 9.1% in 2000 is down another 6.7% in 2001 through June 30th, down another 1.8% so far in July, and investor patience is wearing thin.

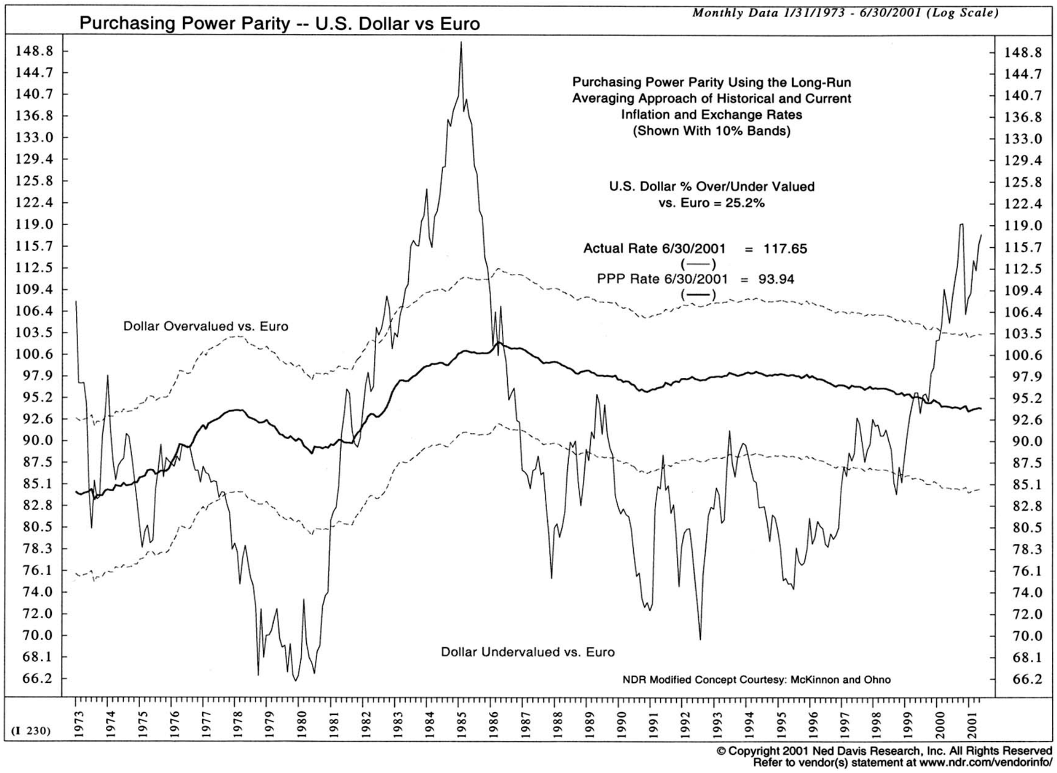
A certain market malaise has set in accompanied by repeated and seemingly perpetual earnings disappointments. Expectations are for a 15% decline in S&P 500 earnings this year. Only last week have there started to appear management comments in the semiconductor industry (Motorola and Taiwan Semiconductor) pointing toward a bottoming of order rates. This industry is currently running 68% of capacity, a 25 year low.

Tech capacity utilization is at 25-year low.

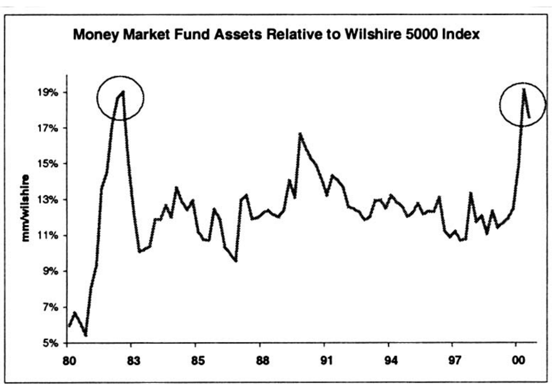
Source: Federal Reserve Board, CSFB.

We expect that the Federal Reserve will continue to lower rates because 1) 'real' rates, i.e., nominal rates minus core inflation, have yet to be reduced to levels seen in prior economic contractions, 2) the failure to produce the desired outcome of a rising stock market (and falling dollar) alluded to earlier sends the message that more is needed, and 3) falling commodity prices reinforce the need for more rate cuts.

The dollar is currently about 25% overvalued in purchasing power parity against the euro. This overvaluation exacerbates the manufacturing sector

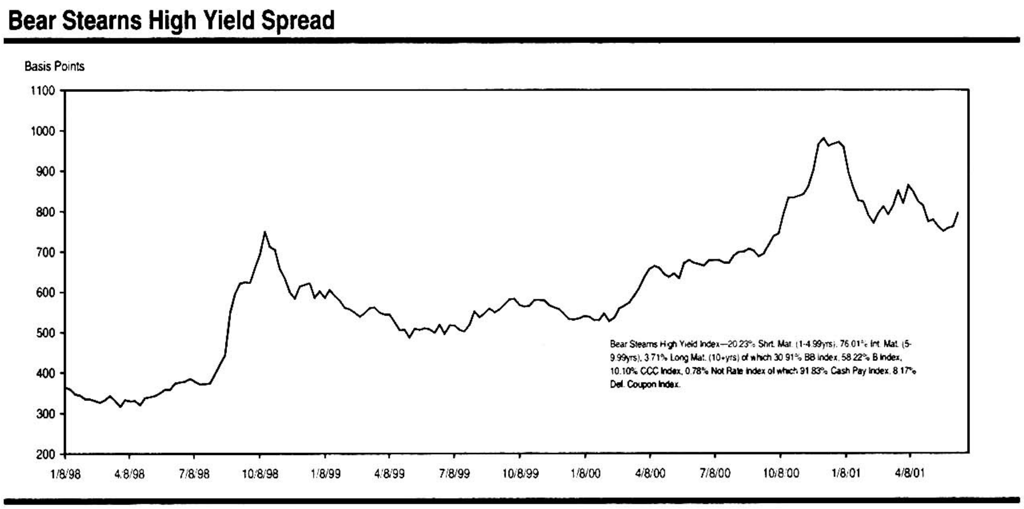


recession by making American goods non-competitive on the world market. Furthermore, excessive dollar strength has sent the likes of Argentina and Turkey into crisis and financial chaos.



Investor reaction to the current stock market uncertainty has translated into high levels of money market fund holdings, the highest relative to the broad-based Wilshire 5000 index since 1982. This is bullish.

Also bullish is the contraction since January in yield spread between high yield bonds and treasury bonds, an indication that the peak in financial stress has passed.



Nonetheless, the market still struggles with the valuation question. Since S&P 500 prices and earnings have declined approximately equal amounts, this has left the numerator and denominator of the P/E ratio of 'the market' largely unchanged, i.e., high by historical standards at about 27x.

We have maintained a largely defensive posture during this troublesome market environment. Our approach brought positive investment results last year and above-market returns during the first two quarters of 2001. The fact that balanced accounts are outperforming equity accounts for the first time in many years indicates just how rough equity investing has been this year. We observe the avalanche of commercials extolling the long-lost merits of owning bonds. Nevertheless, Wall Street portfolio strategists in the aggregate still call for equity allocations of 71%, high by historical standards. This is not bullish.

We continue to emphasize intensive research and unconventional thinking attempting to exploit market inefficiencies. We have invested across most market capitalization ranges in companies undergoing events that we believe cause their stocks to be temporarily undervalued. Assiduously avoiding the siren song which says portfolios are to be fully invested according to what the market or an index 'looks like' has helped keep us out of harm's way.

We dipped our toe into the telecommunications sector during the second quarter, purchasing shares of Nippon Telegraph and Telephone (NTT) and Williams Communications Group (WCG). Not wanting to overload our exposure to telecommunications, especially given the aggressive nature of our investment in Williams Communications Group, we invested half of our typical amount in each of these companies.

In April we purchased Williams Communications Group (WCG) at prices around $4.25. Although more aggressive due to the wide range of potential outcomes, Willams was under the influence of significant selling pressure due to the 86% spin-off from parent Williams Companies, an energy company, and simultaneous removal from the S&P 500 Index. The stock dropped from a high of over $60 per share during 2000 and from prices in the $20s just a few months prior to our purchase. WCG is impacted by the broad-based scaling back of telecom sector spending. Williams expects to be EBITDA (earnings before interest, taxes, depreciation and amortization) positive by Q4 '01, cash flow positive in '02 and free cash flow positive by late '03 or '04. The crown jewel is a 40,000 mile fiber-optic network of which 33,000 miles is 'lit', connecting 125 cities. Strategic relationships exist with SBC Communications, Intel, Telmex, KDDI America, and Teleglobe, and WCG is well positioned to serve bandwidth intensive customers. With $3.1 billion in liquidity, WCG should have adequate funding into 2003.

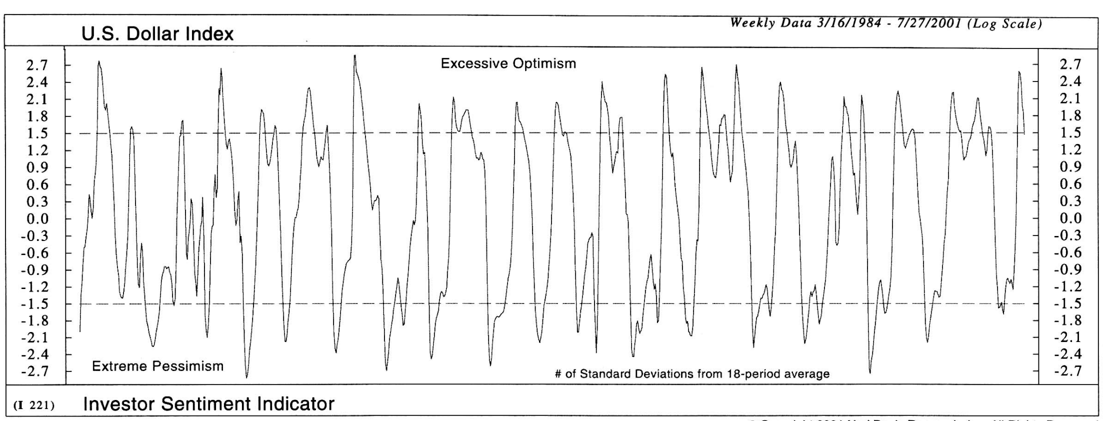
We continue to own Devon Energy in client portfolios. One of the top five domestic oil and gas producers, it has a tremendous track record and should benefit from integrating acquisitions PennzEnergy and Santa Fe Snyder. In June we witnessed the benefit of the company's financial strength, as Devon's investment grade credit rating was confirmed and a stock buyback of up to $1 billion in value, funded from cash flow as opposed to borrowing, was announced. Devon has balanced exposure to both oil and natural gas, commodities which we believe have excellent long-term prospects not currently reflected in the stock price. Recent stock price weakness was largely due to increasing supply and softening demand for natural gas. However, a recent decrease in oil production by one million barrels per day, reminds us that OPEC is on our side.

Devon trades at about four times expected 2001 cash flow, low versus historical and current industry measures. We feel oil stocks, and Devon Energy in particular, have further upside over the next year or two.

Mattel has been one of our better-performing stocks over the past year. Contrary to what many believe, there is more to this than Barbie, Harry Potter, and George W.'s tax rebate. The company has made significant headway in its restructuring plan, steadily improving operational results and returning its balance sheet to its former, pre-Learning Company, state.

Teledyne Technologies (TDY) is also undergoing a turnaround, unfortunately begun after we purchased the stock. The company's electronics, communications, and engineering segments have performed reasonably well, but the downturn in the aviation industry has hit the company's aerospace engine and component revenue hard. Teledyne now trades at valuation multiples substantially below those of competitors. The company sells at 0.5 x revenue (versus competitors at 1.0 to 1.5 x revenue) with virtually no long term debt, and has a P/E ratio of 12 on '02 estimates. Going forward, Teledyne should reap the rewards of an economic revival and its restructuring efforts.

Despite pariah status and the strength of the U.S. dollar, gold stocks in general and our position in Newmont Mining in particular, have done well this year. Hints of inflation have helped. Our commitment to Newmont stems from an anticipated end to central bank selling of gold, and a belief that the U.S. dollar is substantially overvalued and likely to correct. Investor sentiment



regarding the U.S. dollar is two standard deviations above the mean, the highest reading since 1996. Further, the dollar historically has declined during periods of low U.S. industrial production and low real interest rates. Perhaps providing credence to our being labeled contrarians, we believe Newmont Mining adds defense to our portfolio as well as the opportunity to capitalize on expected weakness in the U.S. dollar.

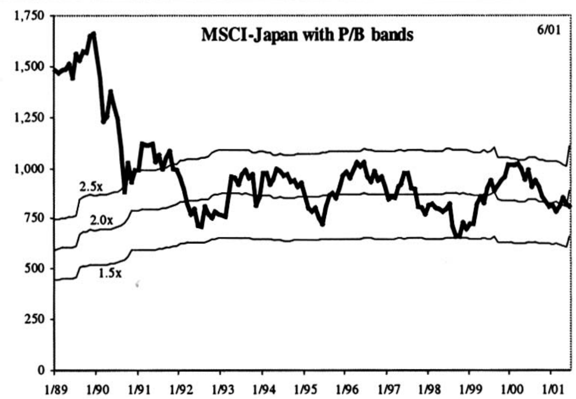
If and when the dollar does decline in value, our Asian holdings will undoubtedly also benefit.

Korea Electric Power trades at five times earnings yet is expected to grow earnings at over twenty percent per year. The stock now trades at less than half of book value, a level last seen at the height of the global currency meltdown during 1998. In addition, electricity consumption is growing at over four percent annually in South Korea, among the fastest rates in the world. The stock has been cheap for some time due to delays in the restructuring of the Korean power sector and further privatization of the company. These events should ultimately occur and unlock value in the Korean monopoly.

Another Asian holding, SK Telecom, is a world leader in wireless phone service, with the highest operating margin and lowest debt ratio in the global industry. The company is seventh in the world in terms of mobile traffic and has easily maintained fifty percent market share in South Korea. Despite all of this, its valuation multiples are among the lowest of worldwide peers. This seems unjust given the company's history of innovation. SK Telecom led the world in introducing CDMA wireless technology, is already offering '2.5 generation' protocol, and will be an early provider of third generation wireless services (streaming data and video through cell phones).

We purchased Nippon Telegraph & Telephone (NTT) around $31/share. In comparison to American Telephone & Telegraph (T), on a cash flow basis NTT is 25% cheaper than T. Additionally, NTT owns 64% of NTTDoCoMo, the preeminent cellular company in the world and acknowledged technology leader. Down from $92/share, NTT is a classic 'low expectation' stock trading at 3 ½ X cash flow in an unloved industry.

Japan — Low Expectations in the Price

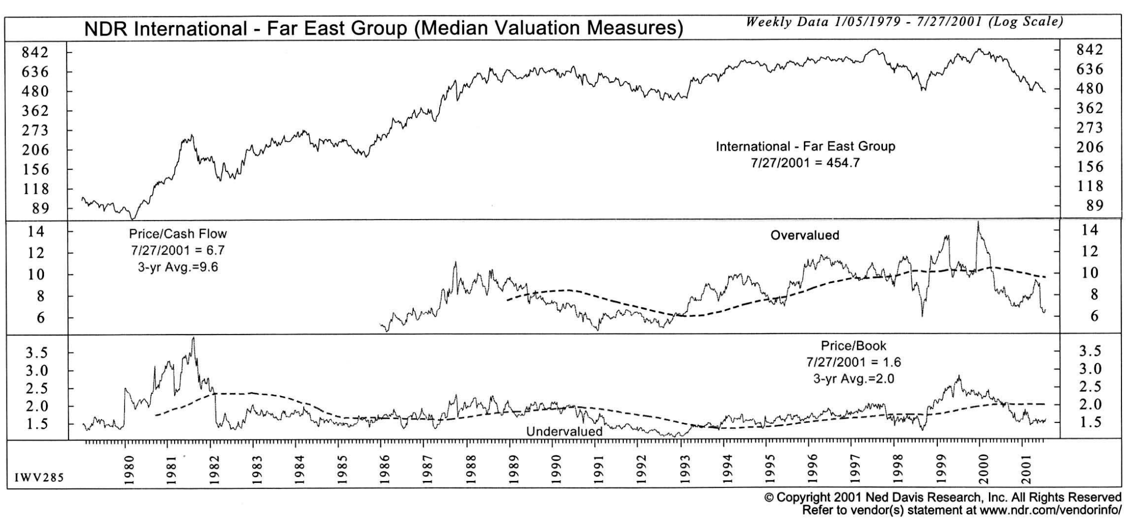


Source: Morgan Stanley Research, MSCI

Japan trades at less than 2X book value as seen above

Avaya has turned in disappointing revenue and earnings, but a bargain-basement valuation has kept it from staying below our original purchase price of 12 3/8. With a return to normalcy in telecom and IT capital spending, Avaya (AV) should benefit. As a spin-off from Lucent late in 2000, its association with Lucent has been a negative throughout this year.

We tendered approximately 40% of our position in Morgan Stanley Asia Pacific (APF) at $9.48 per share to protect against the dilutive affects of not doing so. We continue to believe Asia is the cheapest major market region worldwide as demonstrated by 6.7X cash flow and 1.6X book value (versus U.S. market 17X cash flow and 6.9X book value on the S&P Industrials).



Through our looking-glass… the evidence, though mixed, is beginning to accumulate to demonstrate the Fed's medicine is taking hold. Combined with 1) the one-time fiscal tax-cut stimulus, 2) falling gasoline prices and 3) home mortgage refinancing benefits… these factors should conspire to produce the desired effect… economic recovery. As to the recovery itself, with housing and auto industries already relatively strong, we would anticipate a less robust recovery in general.

Although we believe valuation questions remain unresolved, they need not necessarily be resolved all at once. Given that the 'overvaluation' is the accumulation of multiple years of 'irrational exuberance' as well as being highly concentrated among a minority of large-cap growth stocks, it may be some time before a full reversion is seen. It may well be that the substitution of Social Security taxation with 401K plan capital accumulation has caused a transitional increase in private capital resulting in higher asset prices accompanied by lower investment returns. Time will tell.

**Lewis Carroll's masterpiece brought us not only the powerful imagery of the innocent Alice and the ridiculous Tweedledum and Tweedledee, but also Humpty Dumpty. We cannot resist the parallels between NASDAQ and Humpty Dumpty… and we believe the likelihood of the king's horses and men reassembling either one are equally low.
In the 'Alice in Wonderland' world of the stock market, we think Tweedeldee had it right…"Contrariwise… that's logic!"**

Alice meets Humpty Dumpty

We thank you for your patience and understanding.

Very truly yours,

Alan T. Beimfohr **John G. Prichard, CFA**