

Knightsbridge Asset Management, LLC

October 29, 2001

THIRD QUARTER COMMENTARY

"Those who believed in Islam were known as Moslems, and before long there were as many Moslems as Christians.

At first the Moslems tried to persuade others to join simply by talking to them, but soon they began to force others to become Moslems whether they wanted to or not.

The Moslems said that Allah wanted all people to be Mohammedans and didn't want anyone who was not. Mohammed only lived for ten years after the Hegira (flight from Mecca to Medina), until 632 A.D. But those who came after Mohammed kept on conquering and making people Mohammedans with the sword."



A Child's History of the World
by V.M. Hillyer and Edward G. Huey
1951, Appleton-Century-Crofts, Inc.
Chapter 42, page 247

At age 9, I received this book as a gift from my grandmother who worked most of her adult life at Chandler's Bookstore in Evanston, Illinois at the edge of the Northwestern University campus. Still in my library, this book was my introduction to the unfamiliar world of Islam. Since the Al Qaeda network has been identified in 68 countries, one wonders what the Judeo-Christian world is up against. It is clear that Osama bin Laden and his sympathizers seek to alter the Islamic political landscape in favor of

theocracies, and perhaps Hosni Mubarak of Egypt and Crown Prince Abdullah of Saudi Arabia are even more threatened than Mr. Bush and Mr. Rumsfeld. Given that we have 6000 troops in Saudi Arabia protecting Kuwait from Iraq, and given that we are importing 60% of our oil, the long-term economic consequences of the World Trade Center/Pentagon attacks are essential for investors to ponder.

Perhaps the Koran is a religious work espousing peace and love among its Islamic followers. Historically, however, bloodshed in the name of 'Jihad' has been operative and violence against 'infidels' acceptable. Moorish incursions into Spain and France ended in the famous battle of Poitiers in Tours, France (led by Charles 'The Hammer' Martel, great-grandfather of Charlemagne, in 723 A.D.). The expansion of the Ottoman Empire to the gates of Vienna in 1683 A.D. followed almost a millennium later. These thrusts of Islam northward, characterize the religion's acceptance of brutal expansionism. Some engage in the self-delusion that because the Koran does not specifically endorse the methods used against 'infidels' in the World Trade Center/Pentagon attacks, that somehow a good Madison Avenue public relations campaign targeting Islam and teaching them the error of their ways would be fruitful. We respectfully disagree. Osama bin Laden's agenda is to establish Islamic theocracies to replace secular Arabic governments... notably Egypt, Jordan and Saudi Arabia. Both the Sunni Muslim leadership in Egypt and the Saudi royal family are perilously close to being overthrown by extremist leadership infused with fresh legitimacy by the success of Al Qaeda's attacks. After all, the events of September 11th have captured the world stage and advanced the visibility and importance of Islamic beliefs and fantasies like never before and everybody is listening, even Ariel Sharon and Yasser Arafat. Osama bin Laden is arguably the most popular world figure since Mao Tse Tung. And the likelihood of his being found in Afghanistan must be considered by dispassionate observers to be frightfully low. After all, did we not try to eliminate Fidel Castro, Moammar Khadafi and Saddam Hussein, each without success?

The 'war on Al Qaeda' most likely will resemble the 'war on drugs' rather than 'Desert Storm'. And the costs to the American economy will be comparable or higher, possibly much higher. Therefore, we judge that this 'war', or crusade if you will, will be expensive to the American taxpayers, and result in higher rates of inflation than

currently perceived. Ironically, this spending may be good for equity ownership... for a few years... as governmental outlays help to offset deflationary economic trends currently holding sway.

Oil stocks declined upon the reopening of the NYSE the week of September 17th, ostensibly because the world economy would be further weakened by the 9/11 attacks, thereby lowering already recessionary demand and price levels for oil. We believe, to the contrary, that oil supplies from mid-east sources stand an uncomfortable probability of being disrupted in order to effect a direct overthrow of secular governments. Policy changes will be inevitable if more theocratic Islamic regimes take root. Eradicating the Taliban government in Afghanistan may inconvenience bin Laden, but may not meaningfully alter Al Qaeda. The fact that Saudi intelligence has yet to cooperate with our CIA since last month is testimony to the grass roots power and popularity of the enigmatic bin Laden.

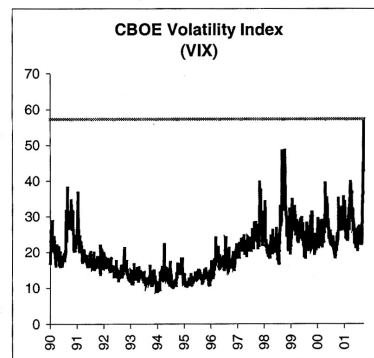
Therefore, we must realistically assess where operation 'Enduring Freedom' is likely to lead. Economically and otherwise. Some early conclusions are:

1. The surplus is gone,
2. The recession is here, with Q3 to be the first quarter of negative GDP growth,
3. Defense spending is on the ascendant, but hardware procurement is probably low priority,
4. We are in for a costly and frustrating game of global hide and seek,
5. Globalization is threatened by any border tightenings: exports to the U.S. by Canada are 33% of Canadian GDP and by Mexico 25% of Mexican GDP,
6. The 'equity risk premium' is now some higher number than before.

To the extent that investors believe we are in uncharted waters, the market will seek levels that adequately discount prospects for uncertain outcomes. Did we get there on September 21st? Maybe... maybe not. At minimum, we need to 'test' the levels achieved on the September 21st lows and given that there was an almost immediate 10% rally off those levels, we should be looking for that test in the next month or so. In fact, the total retracement of the market decline following the 9/11 attacks eliminated the initial compensation provided by a higher 'equity risk premium'.

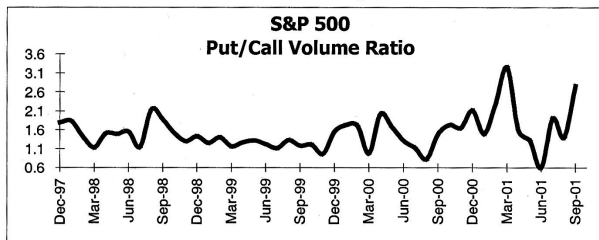
New bull markets rise from the ashes amid pervasive doom, gloom and disbelief. Such beginnings are normally characterized by extremely negative sentiment data... high put/call ratios, high volatility (VIX) readings, high levels of cash, and money market funds... accompanied by margin debt shrinkage (currently shrunk by 42%).

Volatility Extraordinarily High



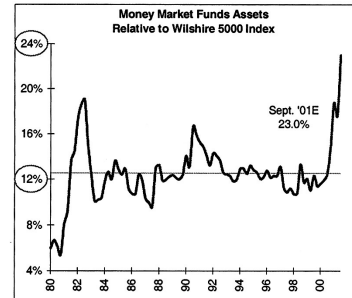
Source: Bloomberg

Pessimism High



Source: DRI

Liquidity at Record Highs



We have achieved most of this. What seems to be missing is an upward 'bullish breadth thrust'; a day's trading where the upside volume/downside volume ratio is at least 9:1. So far we've only had one day at about 5.5:1 (following the March/April bottom we had one day that was 7:1). Not so good. We are, therefore, unsure that a condition of climatic selling actually occurred by September 21st.

In the thick of the present 'crisis', we looked at prior crises and subsequent stock market responses to see if the evidence was strong enough to warrant a reactive response on our part.

Below is a table of market performance numbers following every crisis event since 1914.

| CRISIS EVENTS, DJIA SUBSEQUENT PERFORMANCE | | | | |
|--|------------|----------------------------|------------------|-------|
| Event | Event Date | — DJIA Percentage Change — | | |
| | | % Gain/Loss | Days After Event | |
| | | 22 | 63 | 126 |
| Exchange Closed WWI | 12/11/1914 | 8.1 | 5.5 | 20.4 |
| Woodrow Wilson Stroke | 09/26/1919 | 9.6 | -2.1 | -15.0 |
| Bombing at JP Morgan Office | 09/16/1920 | -4.3 | -12.9 | -12.2 |
| Germany invades France | 05/10/1940 | -23.6 | -17.9 | -9.9 |
| Pearl Harbor | 12/07/1941 | -2.4 | -9.6 | -16.0 |
| Truman Upset Victory | 11/02/1948 | -9.8 | -4.6 | -6.7 |
| Korean War | 06/25/1950 | -8.9 | 1.0 | 2.2 |
| Eisenhower Heart Attack | 09/24/1955 | -6.0 | -0.2 | 5.1 |
| Suez Canal Crisis | 10/31/1956 | -1.2 | -1.9 | 2.3 |
| Sputnik | 10/04/1957 | -6.8 | -5.0 | -5.4 |
| Cuban Missile Crisis | 10/21/1962 | 11.2 | 17.8 | 24.7 |
| JFK Assassination | 11/22/1963 | 3.8 | 8.7 | 12.0 |
| Martin Luther King Assassinated | 04/04/1968 | 5.8 | 6.1 | 9.6 |
| U.S. Bombs Cambodia | 04/30/1970 | -5.0 | -0.8 | 2.6 |
| Kent State Shootings | 05/04/1970 | -3.3 | 0.1 | 3.0 |
| Arab Oil Embargo | 10/17/1973 | -9.6 | -11.5 | -10.3 |
| Nixon Resigns | 08/08/1974 | -16.9 | -15.4 | -10.0 |
| Iranian Hostage Crisis | 11/04/1979 | 2.8 | 7.9 | 0.4 |
| U.S.S.R. in Afghanistan | 12/26/1979 | 4.4 | -8.5 | 4.5 |
| Hunt Silver Crash | 03/27/1980 | 5.7 | 16.5 | 26.6 |
| Falkland Islands War | 04/02/1982 | 2.5 | -3.6 | 7.6 |
| U.S. Invades Grenada | 10/25/1983 | 2.1 | -0.5 | -6.9 |
| Beirut Bombing | 10/23/1983 | 2.2 | -0.4 | -8.0 |
| U.S. Bombs Libya | 04/15/1986 | 0.2 | -0.7 | -0.7 |
| Financial Panic '87 | 10/19/1987 | -14.4 | -12.6 | -10.6 |
| Invasion of Panama | 12/20/1989 | -3.5 | 1.2 | 7.4 |
| Iraq invades Kuwait | 08/02/1990 | -9.8 | -15.6 | -6.4 |
| Gulf War | 01/17/1991 | 17.0 | 19.8 | 18.7 |
| Gorbachev Coup | 08/18/1991 | 1.7 | 3.2 | 9.4 |
| ERM U.K. Currency Crisis | 09/16/1992 | -4.6 | -1.1 | 3.5 |
| World Trade Center Bombing | 02/26/1993 | 2.7 | 5.2 | 8.5 |
| Oklahoma City Bombing | 04/19/1995 | 3.9 | 12.1 | 14.5 |
| Asian Stock Market Crisis | 10/27/1997 | 8.8 | 10.5 | 25.0 |
| U.S. Embassy Bombings Africa | 08/07/1998 | -6.5 | 2.4 | 8.5 |
| Mean | | -1.3 | -0.2 | 2.9 |
| Median | | -0.5 | -0.4 | 2.8 |

Days = Market Days
Performance calculated from trading day prior to event date.

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Obviously some of these events were more impactful than others, but our feeling at the time was that the data did not support our taking reflexive action.

Even if we were to look at all the terrorist attacks since 1979, the conclusion is the same... there is simply insufficient return historically to warrant taking on equity positions because of such crises, absent other factors. Almost all of the events listed in the table below took place in the context of an enormous bull market from 1982 to 1999.

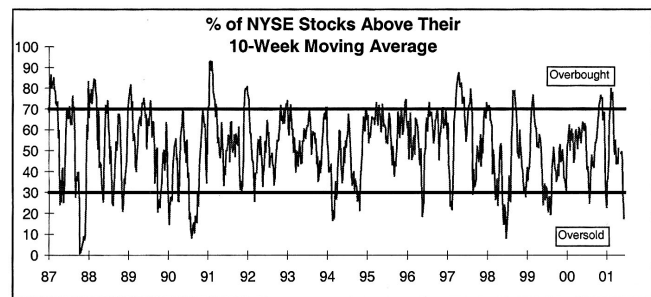
TERRORIST ATTACKS, DJIA SUBSEQUENT PERFORMANCE

| Event | Event Date | — DJIA Percentage Change — | | |
|---|------------|----------------------------|------------------|------------|
| | | % Gain/Loss | Days After Event | 22 |
| Islamic Students Storm U.S. Embassy | 11/04/1979 | 1.2 | 6.9 | -0.3 |
| Car Bomb Outside U.S. Embassy in Beirut | 04/18/1983 | 2.9 | 1.8 | 7.7 |
| Bomb at US Marine Barracks in Beirut | 10/23/1983 | 2.2 | -0.4 | -8.0 |
| Car Bomb Outside U.S. Embassy in Kuwait City | 12/12/1983 | 1.5 | -8.3 | -11.5 |
| Car Bomb Outside U.S. Embassy in Beirut | 09/20/1984 | 1.1 | -0.1 | 4.3 |
| TWA Boeing 727 Hijacked to Beirut | 06/14/1985 | 4.5 | 1.7 | 17.1 |
| Achille Lauro Hijacked | 10/08/1985 | 6.0 | 18.2 | 33.6 |
| Pan Am Jumbo Jet Hijacked | 09/05/1986 | -7.0 | 1.4 | 18.6 |
| Pan Am 103 Explodes Over Lockerbie Scotland | 12/21/1988 | 2.4 | 4.5 | 13.8 |
| Car Bomb Explodes at WTC | 02/26/1993 | 2.7 | 5.2 | 8.5 |
| Oklahoma City Bombing | 04/19/1995 | 3.9 | 12.1 | 14.5 |
| Car Bomb at U.S. Military Headquarters - Riyadh | 11/13/1995 | 7.1 | 15.0 | 14.6 |
| Truck Bomb Outside Khobar Towers in Dharan | 06/25/1996 | -5.2 | 3.1 | 13.4 |
| Bomb Explodes at U.S. Embassies in Kenya & Tanzania | 08/07/1998 | -6.5 | 2.4 | 8.5 |
| USS Cole Bombed | 10/12/2000 | 1.8 | 1.9 | -2.8 |
| Mean | | 1.2 | 4.4 | 8.8 |
| Median | | 2.2 | 2.4 | 8.5 |

*Days = Market Days
Performance calculated from trading day prior to event date.*

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What a quarter. The S&P 500 declined 15%, the fourth worst quarterly decline since 1928. Only 11% of NYSE shares stood above their 50-day moving average at quarter's end.



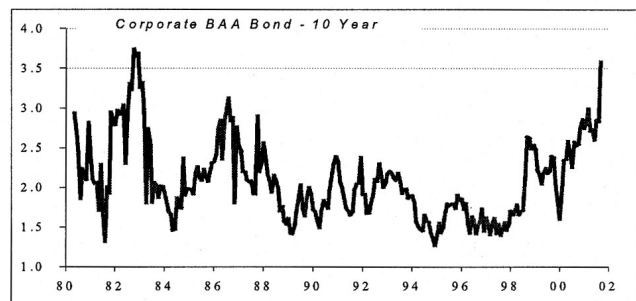
In the week ending September 21st, the market loss, down 11%, was the worst weekly loss in 60 years. One fourth of all equity mutual funds finished the quarter down 30% year-to-date!

The year 2001 has gone down in history as the first year to witness 5 months of equity mutual fund net out-flows.

The IPO market evaporated in September, the first month since 1975 that there were no new stock issues in the U.S.

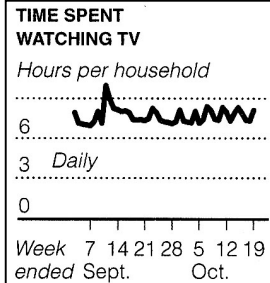
Risk aversion is apparent in both equity and bond markets as spreads between treasuries and BAA rated corporate bonds have widened anew.

Corporate BAA-10 Year Treasury Spread



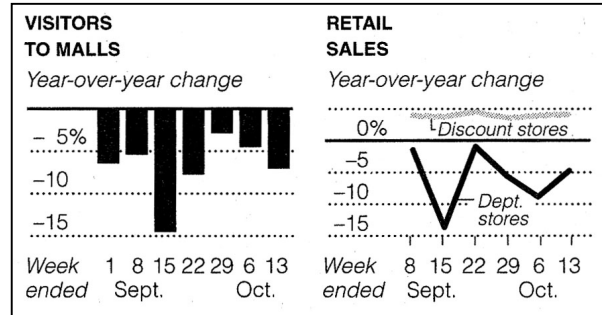
Source: Morgan Stanley Research

In the wake of the Kamikaze attacks on the East Coast the 'CNN-effect' gripped the nation... meaning that substantial portions of

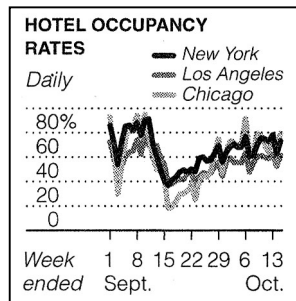


economic activity came to a grinding halt. Hours spent in front of the TV

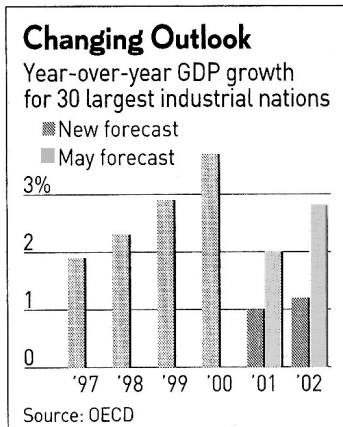
skyrocketed as the nation stared in shared disbelief. At the same time, shopping all but ceased and retail sales slowed markedly.



Then came the anthrax pestilence combined with new procedures for airport check-ins and flight curtailments serving to undermine the travel industry. The repercussive effects on top of pervasive economic weakness have caused a lowering of estimates for GDP growth worldwide, down to the 1% area for 2001 and



2002. In general, lower GDP growth means lower earnings as can be seen below.



| Real Yr/Yr GDP Growth | No. of Observations | Avg. Real Yr/Yr GDP Growth | Avg. S&P 500 EPS Growth | Standard Deviation of EPS Growth |
|-----------------------|---------------------|----------------------------|-------------------------|----------------------------------|
| 7%+ | 10 | 7.8% | 20.9% | 9.9% |
| 6-6.9% | 14 | 6.3% | 19.7% | 12.4% |
| 5-5.9% | 21 | 5.3% | 14.0% | 10.9% |
| 4-4.9% | 32 | 4.3% | 18.6% | 24.4% |
| 3-3.9% | 26 | 3.5% | 7.3% | 14.6% |
| 2-2.9% | 27 | 2.5% | 4.2% | 14.7% |
| 0-1.9% | 16 | 1.0% | -4.7% | 12.8% |
| Negative | 17 | -1.3% | -11.7% | 14.0% |

Fears that Osama bin Laden may have another surprise in store have served to generally curtail economic activity as consumers attempt to assess whether they need to modify their prior behaviors both economically and from the standpoint of physical security.

We are always inclined to lean against prevailing opinion when it comes to market decisions. Like others, however, we await further information to better judge whether certain suppressed levels of economic activity directly related to the 9/11 attacks are 1) temporary, 2) if temporary, how long the recovery to prior levels is likely to be, or 3) whether the current levels of activity

might represent the new 'steady state'. Although there is great temptation to judge that everything will return to pre 9/11 conditions, such conclusions may contain elements of wishful thinking. For example, what is the economic outcome of a biologically contamination-free postal system? We are not sure. Although it is easy to conclude that irradiation of all mail might be the answer, would this solution put the post office out of business (which some may view as a positive)? So far, a roughly 30% decline in air travel does not show signs of returning to normalcy, with ricocheting effects on the hotel and restaurant industry.

In conclusion, we are looking for a testing of the September 21st lows. Upon this test, we believe a more fully invested posture may be warranted as the bear market ends, with the recession ending perhaps in the spring or summer of 2002. In fact, any recovery from the post 9/11 malaise will lend further upside momentum to whatever economic recovery might otherwise have been experienced.

The battle with Islam has been ongoing in one form or another for 1400 years. It will not likely end in our lifetimes, nor will this terrorism be so fortunate in it's next iteration. Adjustments will of necessity be made, and those virtues which have made the USA the greatest success story of any nation-state of the past two centuries will continue unabated. Yes, God bless America.

Very truly yours,

Alan T. Beimfohr

John G. Prichard, CFA

In memoriam:

Cee Cee Lyles, flight attendant, United Airlines flight 93, Newark to San Francisco, crashed in rural Shanksville, Pennsylvania. A mother of 4, she locked herself in a bathroom with her cell phone and described to authorities what was happening. Apparently the terrorists discovered her and killed her prior to the plane crashing. An acquaintance of Rebecca Baca Beimfohr.

Captain Charles Burlingame, pilot, American Airlines flight 77, Washington D.C. to Los Angeles, crashed into the Pentagon. Chuck Burlingame's brother Brad is Executive Director of the West Hollywood Visitor and Convention Bureau, and a friend of Linda Mongno Beimfohr.

To the estimated 150 alumni of Cornell University who perished in the World Trade Center... a list yet to be made public.

-May light perpetual shine upon them-