Knightsbridge Asset Management, LLC

November 5, 2003

THIRD QUARTER COMMENTARY

"I know men of the greatest cunning who are perpetually cheated"

Jonathan Swift, 1667-1745
Irish author and satirist
Author of Gulliver's Travels

The incessant media drumbeat highlighting corporate malfeasance and investment industry shortcomings would have investors believe they are perpetually cheated. And who among us does not feel perpetually cheated every April 15th or with every FICA deduction from a paycheck?

The "hung jury" outcome of the celebrated Frank Quattrone trial demonstrates how difficult it is to prove "obstruction of justice". And it should be difficult. A conviction based upon a single e-mail culled from thousands comes chillingly close to creating a society the likes of which none of us want. The revelation that IPO (initial public offering) allocations were preferentially going to CEO's and CFO's with the power to deliver big investment banking revenues to the likes of Credit Suisse First Boston and others should be no revelation at all. Should not one assume this to be the case? And would not the shareholder constituency of CSFB expect this as a competitive practice

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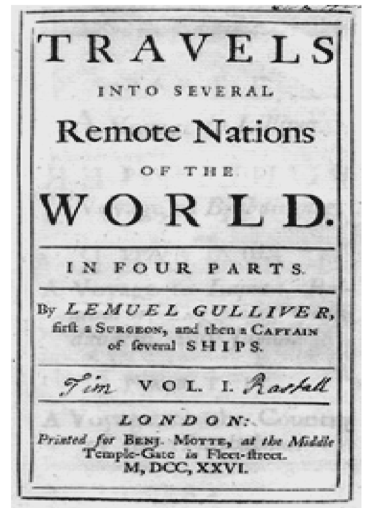
as long as it was legal? The transgression here, if any, belongs not to the Frank Quattrones of the world but to the boards of companies going public who failed to demand a higher price for their shareholders. But then the bear market of 2000-2003 would have been even worse. With apologies to Jonathan Swift, Lilliputian investors would have had Brobdingnagian losses. Instead of Gulliver's Travels, we'd have had Gullible Travails.



TRAVELS
INTO SEVERAL
Remote Nations
OF THE
WORLD.
IN FOUR PARTS.
By LEMUEL GULLIVER,
first a SURGEON, and then a CAPTAIN
of several SHIPS.
VOL. I.
LONDON:
Printed for BENJ. MOTTE, at the Middle
Temple-Gate in Fleet-street.
M, DCC, XXVI.

The mega-bear market of 2000-2003 cost many investors dearly. The resultant lynch-mob mentality, though understandable, is likely to deliver disappointing results to the bloodthirsty, simply because most of the egregious behaviors were not technically illegal. Ill-advised, outlandish and over-the-top, yes. But not illegal. After all, CEO's and investment bankers are surrounded by legions of attorneys of every legal stripe whose job it is to insure that actions being taken are……legal. Perhaps poorly conceived and dangerous to stockholders but nevertheless, legal. Take Enron……$25 billion of off-balance sheet financing was not illegal. Obfuscating, yes, but not illegal.

Many of these behaviors, now considered reprehensible, were to be admired in earlier times. And if punished will require the most arcane legal maneuverings. Moreover, that formerly thought to be simply bad practice must be recodified to illegal.

Prior to the 1930's, stockbrokers who dealt with the public were known as "customer's men". They were called this because their primary allegiance was supposed to be to their customers, not to their Wall Street employers. The goal of this primary allegiance was to protect their clientele from the nefarious activities and manipulative practices prevalent. The crash in 1929 stimulated legislation that produced the Securities Act of 1933 and Securities Exchange Act of 1934. These Acts made for relatively "clean" markets for the next half century. But the 1990's produced another set of investment excesses, most of which were legal under existing law regardless of how unwise history has proven them to be. And so further reforms will blossom to scrub the markets once again of the

sleaze that inevitably is produced by extended periods of uncorrected excess.

To those of you who have your capital managed by Knightsbridge, we assure you we make every effort to avoid investment disasters. But occasionally we too are fooled by management cheerleaders and their coterie of sycophant analysts. Since the owners of Knightsbridge are required to own the same stocks as our clients, this assures that our financial interest is perpetually aligned with our client's interest. We sadly report that this is seldom the case in the mutual fund world, all too infrequent among our competitors, and practically never the case in the brokerage world. We encourage anyone who would hire a money manager to inquire as to what their policies are in this regard. Our belief is, what's good for the goose is good for the gander. This is the principle upon which European merchant banks are run, and it is a good one. Our money should be invested as your money and vice versa. As for analysts that write reports and verbalize opinions publicly, they are in a very different position and should probably never own any of the companies upon which they report, or alternatively, own them all.

Investors who choose to "do it themselves" must realize they could be at a significant disadvantage to investors who are more experienced, have superior information, do it professionally full-time, and are controlling gargantuan amounts of capital. Some viewed the hot IPO markets of 1998 and 1999 as an equalizer, and although the brief ride up may have been exhilarating, the subsequent plummet into oblivion was truly depression-inducing. We would advise most investors to avoid the IPO market completely. Studies which show modestly superior IPO returns to the market as a whole are based on equal dollars being invested indiscriminately among all IPO's. In practice, this is an impossibility since average investors will be denied the "hot issues", or given reduced allocations, and be forced to buy in the "aftermarket" at higher than IPO prices, destroying any perceived advantage.

Although many securities regulations are aimed at leveling the playing field and equalizing opportunity between institutional and retail market participants, seasoned investors know not to bank on this. One must simply assume that others may have more or different information. But more or different information should not necessarily be construed as better information. Moreover, controlled experiments have shown that investors with less information make buy and sell decisions every bit as good as investors with more information, a counter-intuitive conclusion.

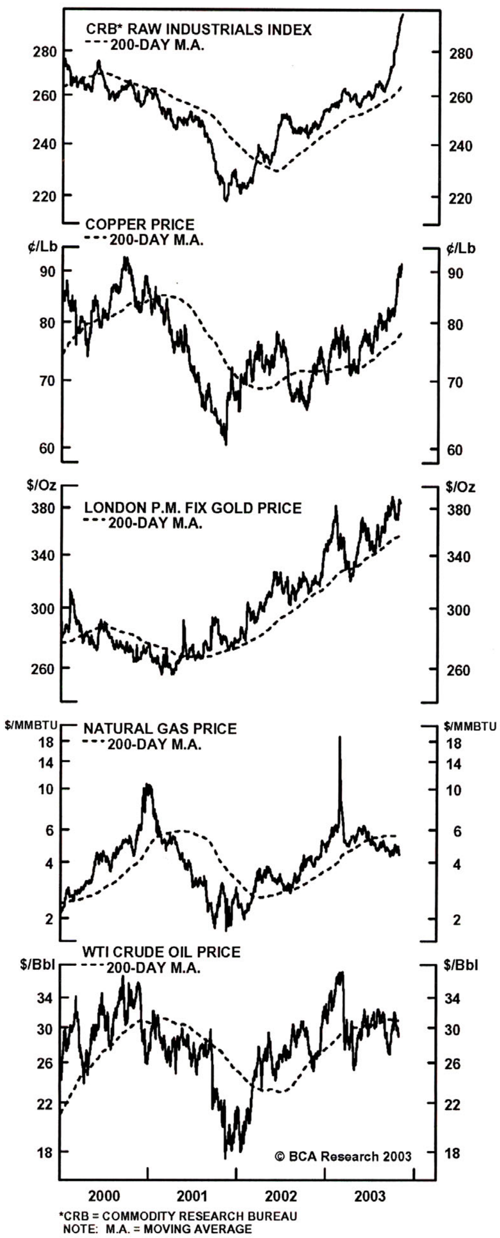
Another study compared the performance of all Wall Street recommendations against all stocks not recommended. The performance difference was about 3% per annum in favor of stocks not being recommended!

Therefore, one should not necessarily ascribe one's meager investment success to lack of information or to an unleveled playing field. Rather the correct attribution is more likely to be emotions and deficient process. This shortcoming may be addressed by an accumulation of experience or the hiring of others. Yet the mega-bear market of 2000-2003 left many investors who have yet to understand the attribution of failure correctly, looking for scapegoats. And the scapegoats have names like "Richard Grasso", "Martha Stewart" and "Frank Quattrone", each a seasonally popular Halloween mask this year. But as the cartoon strip character Pogo reminds, "We have met the enemy and he is us!"

Through the end of the third quarter, the S&P 500 advanced 14.7% in total return year to date. With nominal GDP (gross domestic product) growth spurting upward a blistering 7.2% in the quarter, the economy seems to be rocking right along and according to script. The script is to have a robust recovery just in time for George W. Bush to be re-elected. The fundamental underpinnings of this market recovery lie in an earnings recovery, with reported earnings up 40% in the trailing 12 month period off a cyclically depressed reported earnings trough. So even though the market has advanced at a healthy clip, the fact that reported earnings have advanced even faster means the market P/E has fallen.

So with this great news, what could possibly derail this market? Inflation? Interest rates? No jobs? Budget deficits? The dollar? Oil? Iraq? Trade deficits? And does the market's tepid reaction to the GDP number portend rougher sledding ahead?

The Commodity Bull Gains Strength



THE BANK CREDIT ANALYST November 2003

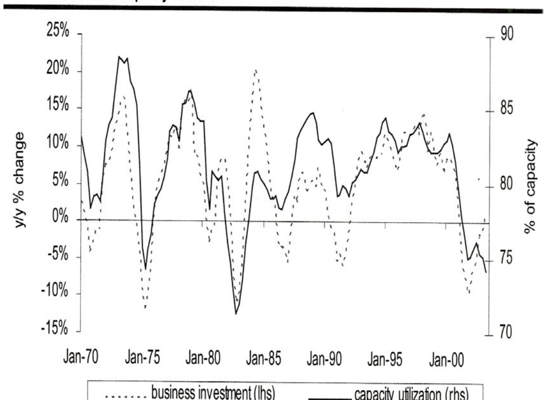
Recent commodity price strength is surely indicative of worldwide economic recovery. But what about inflation? It has only been a few months since we heard some Fed board members expressing concerns of deflation. What is going on here? From the charts at the left it is fairly obvious that commodity price pressures are strong even while factory capacity utilization hovers in low numbers. But according to Goldman Sachs' economists, it "appears to take a 20-30% increase in commodity prices to move CPI inflation by 1%". Therefore, one might conclude that the 36% rise in the "CRB Raw Industrials Index" from 220 to 300 over the past 2 years, as seen at the top of the page, would translate into an increase in CPI inflation of perhaps 1.5% or so, again, over two years. If so, this would be good news for Fed policy makers who would like to create a little good-old-fashioned inflation.

As for what effect a decline in the dollar would have on inflation, it appears a 10% decline in the dollar produces about a 0.5% increase in CPI (imported goods cost more).

Much has been made of the "jobless recovery". Ample evidence shows hiring to be a very lagging indicator, and so it is this time. However, we believe there is a larger story that explains why jobs are still being lost, with factory capacity utilization still persisting at what would have been considered historically recession levels. We

believe this story is one of corporate tax policy; specifically inadequate depreciation and amortization combined with debt issuance incentives related to deductibility of interest expense, particularly as it relates to industrial Europe and Japan, both of which are losing domestic manufacturing as well, but seem to be able to modernize facilities nevertheless. In other words, we wonder how much of the presently unused manufacturing capacity is ever coming back to productive use, much like the surplus aircraft sitting in the Mojave Desert, collecting dust.

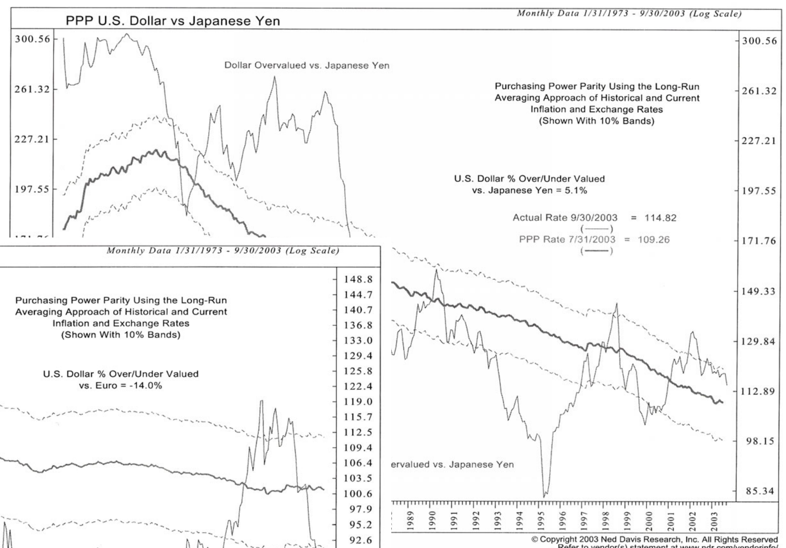
U.S. Investment and Capacity Utilization



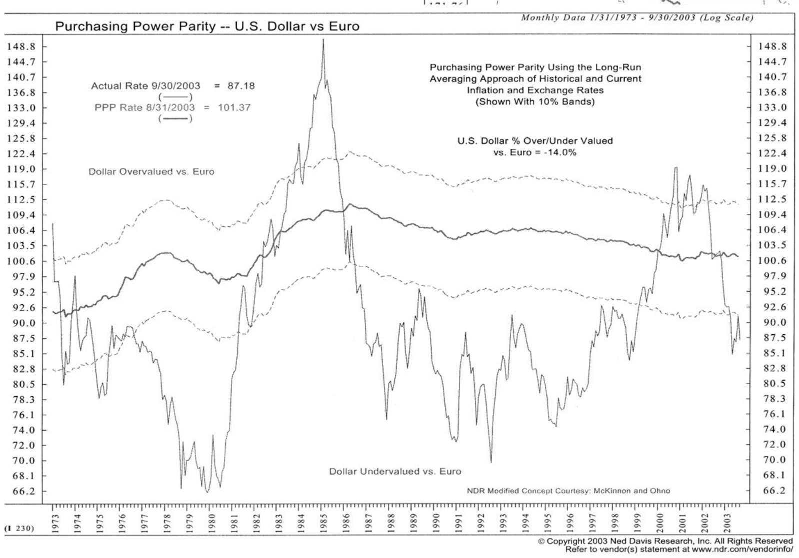
Source: Haver; Bear Stearns & Co., Inc.

Much is starting to be written about the U.S., Japan, and Germany becoming service economies.....losing most of their manufacturing employment to second and third tier nations. This trend is entwined with "globalization", which, if carried to its logical conclusion, means the lowest labor cost (and hence, manufacturing cost) nations must take per capita income growth from higher labor cost nations until incomes are completely equalized, absent compensating trade barriers. Granted, there are other factors at play, but in essence a country like the U.S. with a per capita income of some $30,000 versus a China at $1,000…..there is simply no currency adjustment between the Chinese renminbi and U.S. dollar that will reverse the present trade imbalance. The recent feeble attempt to jawbone China into floating the renminbi from its fixed rate tied to the U.S. dollar proved feckless. The real trade imbalance culprit is imported oil, and sooner or later, U.S. policymakers will need to deal with this issue, politically unpopular or not. It does not appear present policies with oil-rich middle eastern nations like Saudi Arabia and Iraq are destined to flood international oil markets with cheap oil, nor does the Russian situation appear to be encouraging after the Putin administration's arrest of Yukos Oil's CEO, a capitalist-unfriendly move. Therefore, we do not see an easy resolution to the trade imbalance issue, and do not believe the pursuit of currency adjustments to be the answer. In fact, it appears the purchasing power parity of the dollar is such that it is only overvalued relative to the Japanese yen and not the euro. In fact, the euro may be overvalued by some 15% as seen here in terms of purchasing power parity against the dollar. Therefore, we do not foresee forces that would cause a flight of capital from the dollar to the euro, the only currency with comparable liquidity.

Yen undervalued



Euro overvalued



We expect CPI inflation to increase to 3%-4% in the next few years, but believe the market P/E can weather this onslaught. Were the U.S. to sustain its current level of expenditure in Iraq for an extended period, we would expect less friendly outcomes than have been seen to date.

We thank all our clients for giving us the opportunity to recover the losses of 2001 and 2002, and forge ahead.

Very truly yours,

Alan T. Beimfohr   John G. Prichard CFA