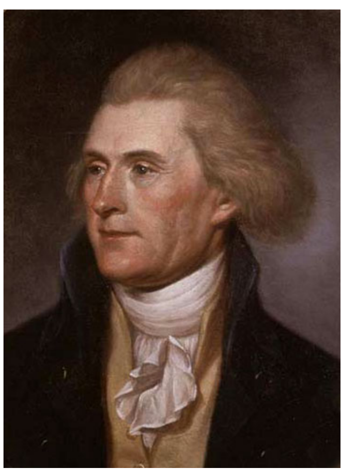
Knightsbridge Asset Management, LLC

February 1, 2008

FOURTH QUARTER COMMENTARY

“I seriously believe that banking establishments are more dangerous than standing armies, and that the principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale.”



Thomas Jefferson, 1743-1826
Author, Declaration of Independence
3rd President of the United States
Letter to John Taylor, 1816
The Jeffersonian Cyclopedia, #689

Jefferson’s disdain for banks was well documented. On multiple occasions he alluded to the unjustified speed with which bank credit was being expanded in this fledgling nation. At one point he exclaimed “I am too desirous of tranquility to bring such a nest of hornets on me as the fraternity of banking companies.”

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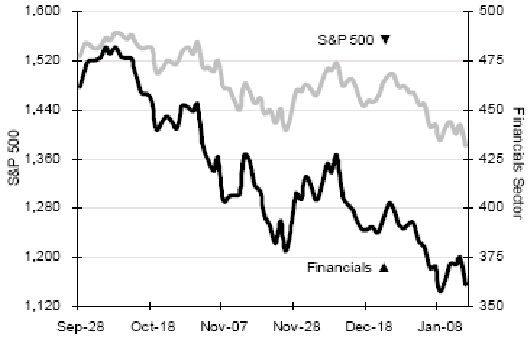
The nest of hornets has descended upon the markets with ferocity. Markets have been roiled by a series of crises originally emanating from sub-prime mortgage lending (we call it "the gift that keeps on giving"), now spread to structured investment vehicles (SIV's), collateralized debt obligations (CDO's), and importantly, the insurers thereof, who also happen to be insurers of municipal bonds. Municipal bond markets are now trading only upon the issuers' underlying credit, under the assumption that the insurance which provided the AAA ratings is worthless. Attempts by AMBAC and MBIA, the two largest insurers of bonds, to receive fresh injections of equity capital have failed following the default of ACA Capital, a "smaller" insurer who had insured "only" $75 billion in debt. The municipal bond insurers had "diversified" ("de-worse-ified" as former Fidelity Magellan portfolio manager Peter Lynch would say) their business by providing insurance against default of various corporate and mortgage-backed security credits as well as in what is known as the credit-default swap market, and have been insuring between $25 and $30 of obligations for every dollar in balance sheet equity. Last month Merrill Lynch disclosed it had purchased about $20 billion in credit-default swap protection last summer from financial guarantors to insure against losses on collateralized debt obligations. Whether this protection will indeed protect will soon be seen. Now the guarantors are in question, as Moody's has threatened downgrading MBIA, the world's biggest bond insurer. On January 30th, S&P announced they were downgrading $270 billion (35% of world total) in mortgage-backed securities and contemplating a downgrade of $264 billion of CDO's (i.e., they are placing them on "negative watch" in the parlance of the trade). With this backdrop, both the New York Federal Reserve and the New York State Insurance Commission in a coordinated effort are trying to stave off the specter of a complete implosion of the bond insurance industry, the details of which are yet to be made public. The industry guarantees $2.4 trillion (that's $2,400 billion) of bonds. No small problem. That this turmoil has taken its toll in the stock prices of financial stocks can be seen below, current as of January 15th.

> **MBIA admits mistakes**
> Gary Dunton, chief executive of MBIA, admitted that the world's largest bond insurer had "made mistakes" and underestimated the risks associated with guaranteeing bonds backed by risky mortgage assets.
> *Financial Times, 2-1-08*

Exhibit 1. S&P 500 Financials Sector Performance, October 9 to January 15

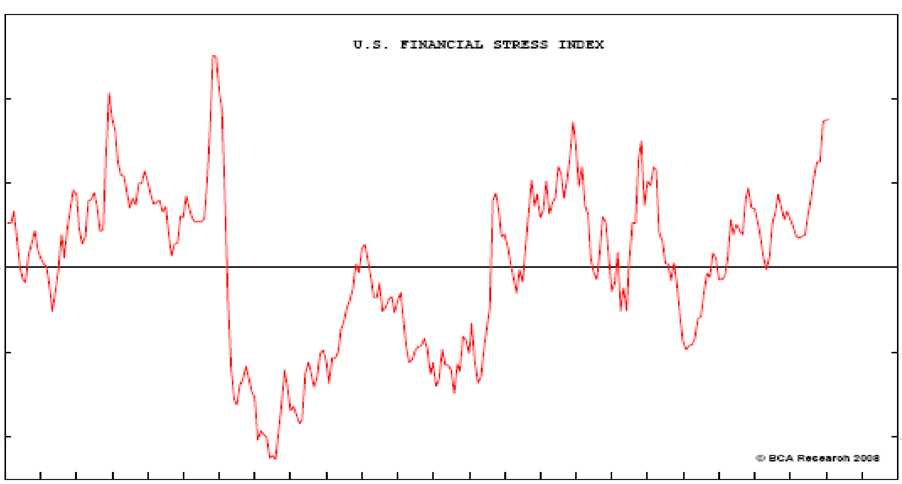


Sub-Sector	Price Return 10/9 - 1/15
Thrifts & Mortgage Finance	-49.8%
Consumer Finance	-38.9%
Regional Banks	-30.1%
Large Diversified Fin. Svcs.	-31.1%
Real Estate	-27.9%
Diversified Banks	-26.0%
Investment Bank. & Brokerage	-24.4%
Insurance	-13.6%
Specialized Finance	-13.2%
Asset Mgmt. & Custody Banks	-8.3%
Financials Sector	-25.1%
S&P 500	-11.8%

Source: Reuters; FactSet Research Systems Inc.; Bear, Stearns & Co. Inc.

--Bear Stearns Investment Strategy 1-16-08 “weekly highlights”

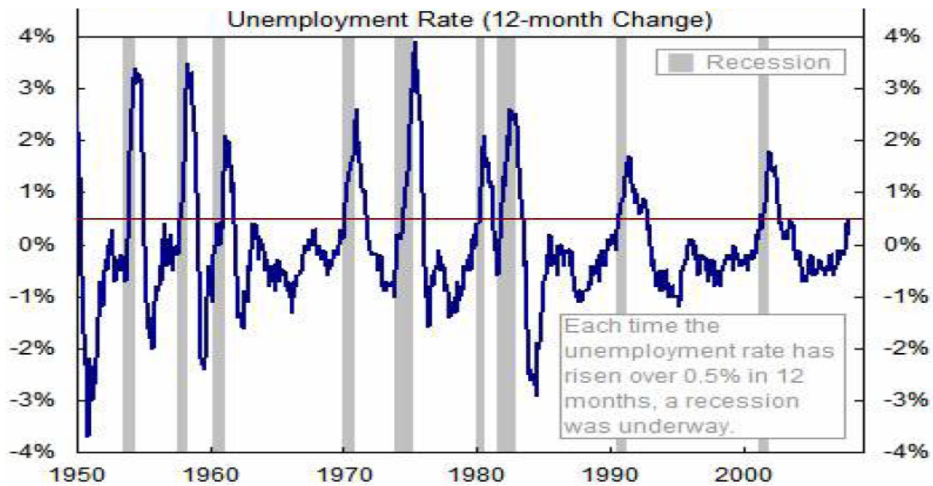
These events, combined with a weakening economy as shown by December’s unemployment numbers released early in January, seem to have been the impetus for a surprise 75 basis point cut between normally scheduled Federal Open Market Committee (FOMC) meetings, a truly unusual event. This was followed by an additional 50 basis points on January 30th bringing the Fed Funds Target Rate down to 3.0% from 4.25% in just nine days. Since most financial institutions are in the business of “borrowing short and lending long”, having short term interest rates substantially lower than long term interest rates is a prescription for bank rehabilitation. This time honored technique was used during the savings and loan crisis, and has clearly been dusted off for current use. Yet further drops in short term rates should be in store given stresses still in the system, perhaps bringing the Fed Funds Target Rate to below 2%. Certainly the shortest rates need to be meaningfully below ten-year treasuries, currently yielding what seems to be an astonishingly low 3.7%.



* Based on banks stocks relative performance, the yield curve, credit spreads, real stock prices, consumer confidence, market leverage, private debt, new bond and equity issuance.

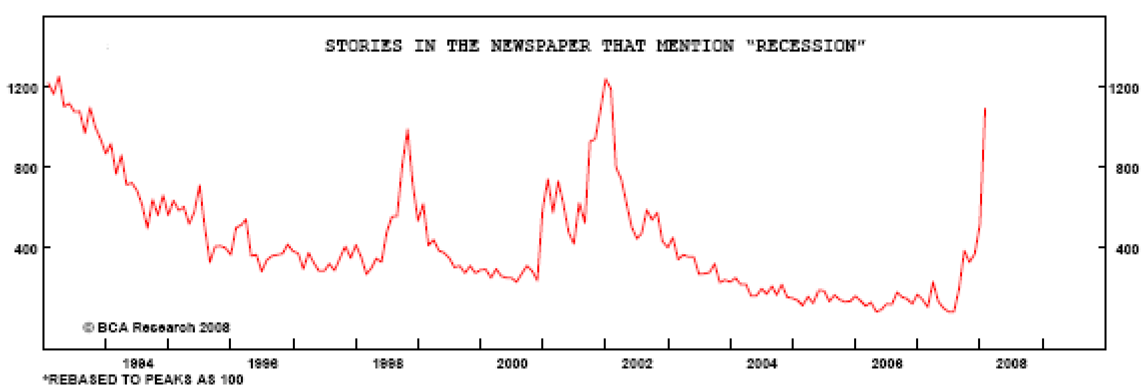
--BCA Research, Global Investment Strategy, Strategy Outlook, 12-14-07

The stock market did not take kindly to the credit market tumult in its latest configuration, and especially to the prospect of "recession" as signaled by December unemployment rising to 5.0% from the lows of 4.4% earlier in the year. As can be seen in the chart below, whenever unemployment increases from its lowest reading by 0.5%, a recession is in progress. Therefore, any unemployment rate above 4.9% qualifies in this economic cycle given that the trough rate was 4.4%.



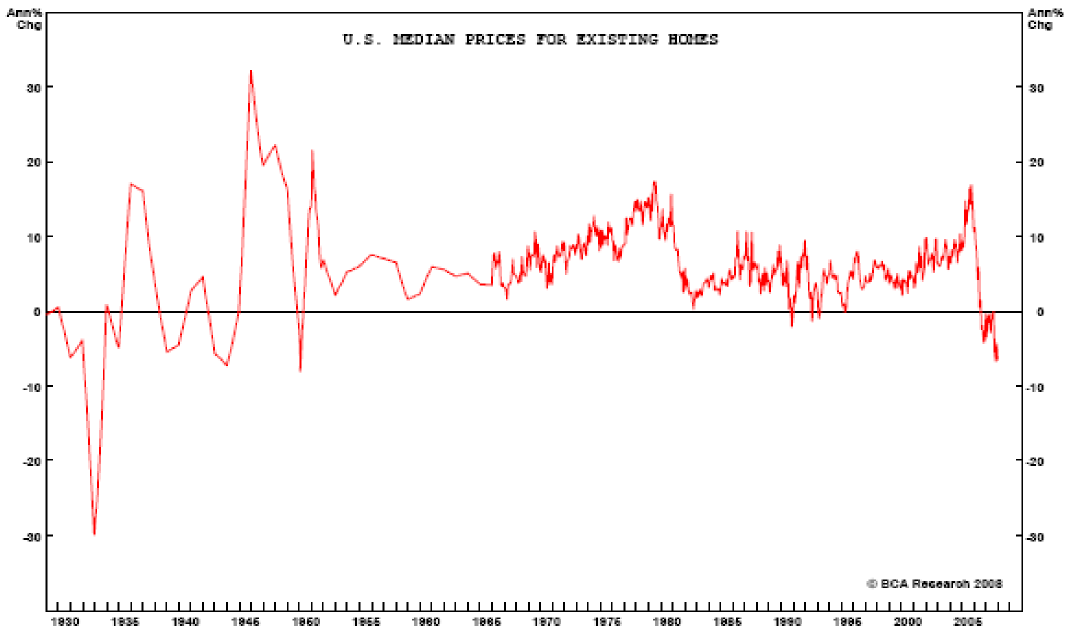
--frontlinethoughts.com, 1/9/08

That the indicator above has called the start of, or has indicated the existence of, recession, nine times out of nine since 1950 is remarkable. Such accuracy in the heat of controversy makes for compelling statistical evidence. Moreover, although the preponderance of professional economists has yet to be convinced we are in recession, certain luminaries such as Alan Greenspan and the chief economists for Merrill Lynch and Goldman Sachs have declared it to be likely so, and the controversy has become headline material as can be seen below.



--BCA Research, Emerging Markets Strategy, 1-25-08

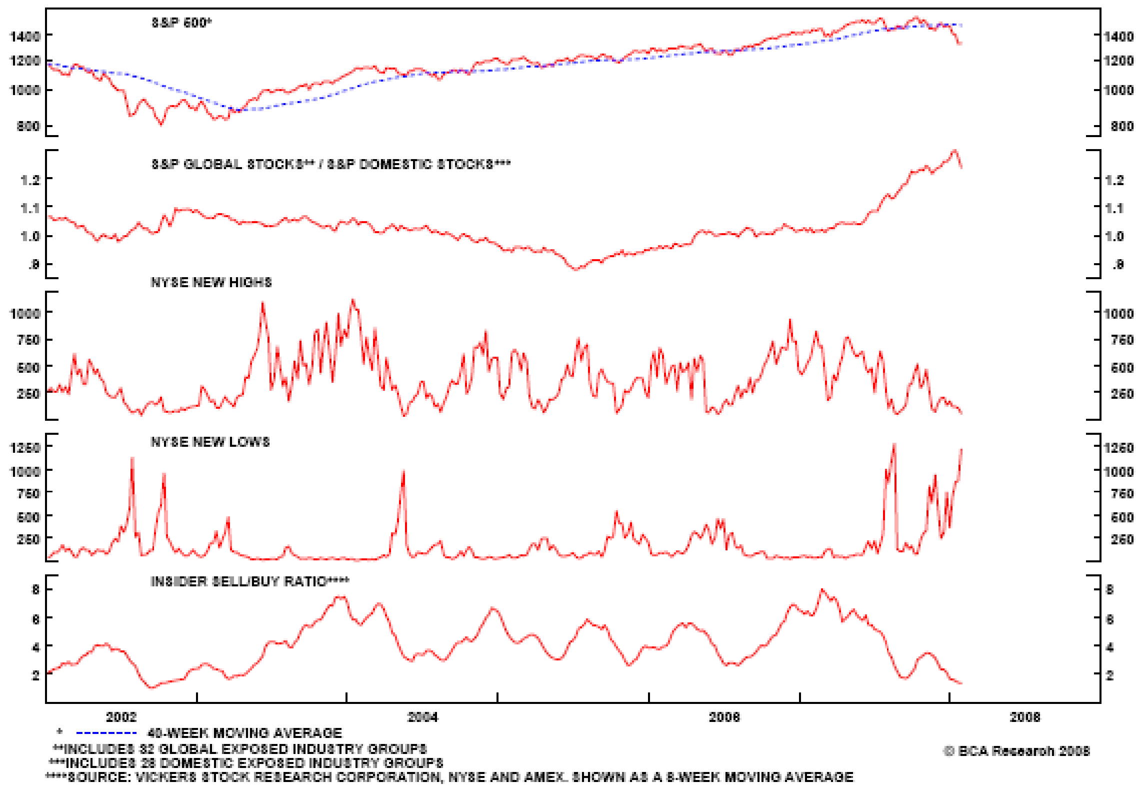
The decline in residential real estate prices has gained enough momentum that almost certainly, as can be seen below, the drop will equal or eclipse even the decline in 1950, and those intermediate years going all the way back to the depression lows of 1932-33. The lowering of short-term interest rates has come none too soon, as many homeowners will be given a reprieve if they can refinance at a floating rate, provided their equity cushion has not completely evaporated. This will be important to consumer psychology going forward.



--BCA Research, Global Investment Strategy, Special Report 1-25-08

The market decline in January was steep, a negative return on the S&P 500 of 5.9%. This was on top of a negative return of 1.4% in the last six months of 2007, much of which occurred in a brutal November which by itself was down 4.2%. Just prior to Mr. Bernanke returning to the party with the punch bowl, many averages were down 15% or more by January 23rd. There is more than a credit crisis for investors to worry about. Oddsmakers have a Democrat booting out the Republicans from the White House, and both Clinton and Obama are committed to tax increases for capital gains and income. Former U.K. Prime Minister Tony Blair admonished both candidates to continue supporting free trade and globalization, though populist and protectionist leanings are pulling in the opposite direction. Moreover, Moody's has declared that U.S. Treasury bonds, notes and bills will lose their coveted AAA rating in about ten years if present trends continue.

Nevertheless, in the midst of all this negativity, the preconditions for a better market are beginning to appear. Divergences often foreshadow a change of direction in the making, and as can be seen below, the number of new lows on the NYSE is subsiding from a high level, and the number of new highs is similarly increasing from a low level. Additionally, insiders remain big buyers of their own stock.



--BCA Research, US Investment Strategy, weekly bulletin, 1-25-08

We suspect that the lows already seen two weeks ago will need to be tested. We expect that enough negativity has been generated to allow for a respite from the market storms, especially in light of the aggressive moves by the Fed the past two weeks which has given investors who may have felt the Fed was behind the curve fresh hope. Following that will be the true test of whether the bear market has seen its lows. The average post-war recession has lasted 10 months. The stock market has typically bottomed out right smack in the middle of that ten month period. Therefore, if we are in recession already as some claim, having entered in December, we should theoretically exit in September, and the stock market should be bottoming in April. We'll see. So far, very little has been "average", and we are reminded of the six-foot man who drowned crossing a stream that was four-feet deep "on average".

Thomas Jefferson despised banks and bankers. In fact, he really took to heart the phrase from Shakespeare's Hamlet "neither a borrower nor a lender be". In the current crisis it seems we, as a modern society, must discover the degree to which this thinking can safely be ignored.

We thank all our readership for their interest and forbearance in light of current circumstances as we look forward to better times.

Very truly yours,

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