

October 17, 2008

To our Clients:

Even though we just mailed the third quarter letter less than two weeks ago, so much has happened in both the stock market and the world at large that we thought you would want an update. As of last night (October 16, 2008) the S&P 500 is down 19% for October, the worst month since the market crash in 1987. Even worse, the market's decline this year has been 35%, an annual loss not experienced since 1937. The average Grisanti Brown portfolio, helped by a cash cushion and limited exposure to the financial sector, has outperformed the market this month, but has still suffered losses. That is the bad news, and it's pretty ugly.

But there are also some positive developments. First, we believe that the recent decision announced by the U.S. government on October 14, 2008 to buy direct stakes in U.S. money center banks represents the beginning of the end of the credit component of this financial crisis. As we slide into a recession this may not seem comforting, but it is a critical, positive fact that the failure of large U.S. financial institutions has once again become remote. The move by the U.S. Treasury (in coordination with numerous foreign governments) has great psychological import, far eclipsing the dollars spent, and we believe it has sent a signal that the failure of any major U.S. financial institution, including the highly-levered investment banks Morgan Stanley and Goldman Sachs, is now so unacceptable that the U.S. government will pledge its full faith and credit to prevent it. A line in the sand has been drawn, finally. This must be understood as the beginning of a restoration of confidence rather than a sudden resurgence. As proof of easing credit conditions, LIBOR (one highly watched measure of short term liquidity) has declined this week for the first time since July.

While we anticipate moving onward from the credit crisis, we are by no means out of the woods. Clearly a recession of indeterminate length and depth now awaits us. The stock market, after posting a 900 point gain when news of the banking infusion broke, is now trying to discount how bad things are going to get for the non-financial part of our economy. Typically the stock market declines sharply as the economy enters a recession. What's different this time is that the financial crisis preceded the recession by about a year, and the market has been declining the entire time. The S&P 500 is already down 38% from its highs of a year ago. This exceeds by a good margin the average decline in either a bear market or a pre-recession slump (often they are the same event). Clearly, since our slowdown has been preceded by a fierce financial crisis, it is not your garden variety recession. Still, a 38% decline -- with many stocks being down significantly more -- represents an awful lot of discounting. We believe valuations are now very attractive, even assuming an 18 month slowdown, which would be the longest of the post war era. The problem is that valuations do not seem to matter right now. Stocks are not declining because fundamental valuations are expensive; they are falling due to panic and forced liquidations. That is what happens in a bear market.

Therefore, let's review what we don't know, and what we know. First, we don't know when the market will bottom, and we also don't know at what level the bottom will be. At any arbitrary time in the short term – month-end, year-end – we have no idea how low it can go. That is a very scary prospect.

But what we do know is that our portfolio of large, high quality companies will continue to operate. Our current estimates, even in a tough recession, show that every company we own should remain profitable. Part of our research process is to determine, separate and apart from the stock exchange, an objective price that a buyer would pay to receive the stream of profits from these companies, which we call the company's "Intrinsic Value". While the Intrinsic Value should be relatively insulated from the panic in the public markets, it is not entirely unchanged by outside circumstances. It is affected by, among other things, the availability of credit, and a buyer's relative optimism or pessimism about the future business prospects of the company.

We also know that panics don't last forever, and that stocks absent panic should trade towards their Intrinsic Value. We recognize that fear does not disappear quickly, regardless of strong market action on any given day. But there are signs we may be near a bottom. Record high volatility (as measured by the VIX index); panic selling at any price; record high corporate bond yields versus Treasuries (reflecting an expectation of corporate bond defaults greater than what occurred in the 1930s); record mutual fund redemptions to put money in liquid instruments with practically no yield; and a 40-year low in consumer sentiment. Further, the decimation in value stocks – our neighborhood – has now lasted for two years. When we compare our performance to that of our high profile and savvy competitors, we're all doing terribly. Some of the most talented are doing even more poorly than we are, some are doing better, but in either case not by a lot. Dismal results won't last forever, and the stocks we are buying now represent the best values we have ever seen. Period. For that reason, even amid this volatility, we are starting to use some of the cash that has allowed us to outperform during these terrible weeks in October.

We want to be clear: We would be net buyers, not sellers, of stocks at these levels. We entered October with a cash cushion, and while we are being very mindful of price and volatility, we are now selectively using some of that to invest. We have no idea whether this is the bottom in the short term, but we are confident we are buying high quality, profitable companies that have market leading positions and really cheap valuations. We are buying shares of **Pfizer**, for example. It is selling at 6 times earnings, an historical low, yielding over 8%, with 20% of its market capitalization in cash, and it is one of the few remaining U.S. firms with a AAA rating. **Chubb**, one of the nation's premier insurance companies, is rated AA+, and has not sold at tangible book value (the value of all its tangible assets minus liabilities) at any time in the past 20 years (as far back as our records go). It sold at that valuation last Thursday, and after a thorough vetting of its investment portfolio, we are buying shares.

In this emotional time, we are paying attention to our investment process more than ever. We are double-checking the book values, the safety of dividends, and the

likelihood of earnings reductions. Above all we want strong balance sheets and profitability. We are trying to tune out the panic moves as we build a portfolio designed to carry us into normalcy – whenever that might arrive – in a very profitable way. More than ever we appreciate your support at this difficult time, and we sincerely believe that staying the course in these dark hours will reward us all.

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