

October 15, 2009

Dear Investors and Friends,

A Brief Review of the Year to Date

Our decision late last year to allocate a significant portion of our portfolio into corporate bonds and bank loans via individual issues and closed end funds trading at discounts to their net asset values proved to be prescient. Through the first three quarters we have seen this trade appreciate substantially, providing equity-type returns with a less volatile risk profile. The decision to “move up the capital structure” was one we made opportunistically during the nadir of the credit crisis and is not reflective of a broad, structural or philosophical change in our typically equity-focused strategy.

The blueprint we devised last winter predicted that asset classes would need to differentiate themselves from one another again before individual issues could begin trading based on their company specific traits. With the correlation of seemingly all asset classes moving toward one, meaning prices of different assets moved in tandem rather than counter-balancing one another, we did not feel like we could add value by continuing to try and pick individual winners and losers. However, we did feel confident that we could identify assets with senior positions inside the capital structure that should trade higher than asset with less senior positions within the capital structure, given comparable credit risks.

This investment strategy seems rather straightforward in hindsight, but at the time, it was not widely discussed or pursued.

By the end of the first quarter and into the second quarter, corporate spreads tightened and our “capital structure trades” began to appreciate, as risk measures were showing some hints that the markets were healing, even as equity prices continued to fall. That process was the first sign of recovery and it signaled us to begin buying high quality, cash heavy, blue chip equities, which were then trading at compelling multi-year valuations.

Assessment of the Third Quarter

The third quarter was another strong quarter for our strategy. We began building and refining our *Kingfisher 99* watchlist of emerging growth, “gravitational” and



opportunistic investment ideas, which best reflect our views of where investment capital

Gravity Investing™ seeks investment themes with predictable outcomes that we believe are likely to occur.

- **The emerging global middle class:** higher standards of living
- **Global infrastructure:** highways, airports, seaports, pipelines, power plants, and electric transmission
- **Web 2.0:** cloud computing and virtualization
- **Water shortages:** falling water tables, desalination, agriculture and energy impacts
- **Clean technology:** alternative energy grid parity, low-cost wind, solar, geothermal and waste-to-energy
- **Smart grid:** automatic meter infrastructure, power demand management and energy efficiency
- **Healthcare innovation:** electronic health records, medical diagnostics, generic pharmaceuticals
- **Climate change:** managing the corporate carbon footprint, carbon allowance trading, creates incentives and challenges and opportunities facing industries, pioneers and dinosaurs
- **Peak energy:** depleting oil, gas, coal and uranium supplies
- **Interest rate cycle:** approaching a 30-year low in midst of record-breaking fiscal deficits?
- **Living in the “new normal”:** credit contraction, weak dollar

will begin to flow in a more normal, though still constrained, credit environment. These themes represent key global and domestic opportunities and serve to complement our bottom-up, core holdings.

During Q3, we saw big wins in a few distressed investments we bought earlier in the year, while continuing to hold significant fixed income and preferred equity positions, which created a bit of drag as low quality stocks pushed higher during the summer. We trimmed several winning positions during the quarter and have been generally working down cash positions throughout the three month period. However, the ongoing pace of the equity market rebound has left us reluctant to chase stocks too aggressively and we have been content to earn our returns in what we have deemed safer strategies.

Looking back on our year-to-date, we were able to outperform our benchmark by employing an active and flexible approach within our investment discipline, which allowed us to capture all of the market’s upside while exposing your capital to substantially less equity risk. This approach was in marked contrast to many of our counterparts, who merely held stocks all the way through the bottom this

spring. Had the market NOT rebounded as sharply as it has this year, we believe our more conservative posture would have protected your capital with a higher margin of safety.

Looking Ahead

Today we believe the market has partially healed, reflecting a more normal, although still very weak, outlook. It will be important to begin to see more tangible signs of recovery over the coming months in order to further propel the markets higher. Late last year, liquid, tradable markets became dysfunctional and actually began reflecting asset prices below their non-liquid counterparts. The recent 50% recovery from the March bottom has



eliminated that arbitrage. Now the test for the market as a whole will be the economic recovery globally.

Should the economic recovery begin in earnest, our game plan is to exit our “capital structure trades and reinvest in higher growth alternatives. Our core equity approach will continue to seek to invest in strong global franchises with competitive moats, strong balance sheets and good dividend yields. In addition, we believe the companies levered to our unique themes will benefit from emerging, gravitational trends, regardless of some of the challenges facing the US consumer.

Today is a particularly exciting time at Kingfisher Capital, in part because much of the focus of our gravitational research over the last five or six years is beginning to migrate toward mainstream adoption. You have heard us discuss these investment themes many times in prior letters: emerging clean technologies and smart grid, global water and energy issues, impending climate change policy and regulation, and the changing consumer landscape in Asia. A modest recovery in the capital markets will fund growth for companies who are best positioned in these areas and prove uniquely beneficial to our investment concentration.

Innovation and transformation rarely create new prosperity without commensurate sacrifice. We are in the midst of a creative-destructive process in which legacy entitlements, industries, and businesses are being re-invented, replaced, and restructured. The current transition is necessary to attempt to stem the tide toward irrelevance for individuals, companies, and even our nation as a whole. But the prosperity that awaits those entities which can effectively innovate and transform will be unusually high given the broad weakness from which we are currently emerging.

Thank you for investing with us. As always, please call with questions or to schedule a meeting with our team.

Kind regards,

Alex

Alexander B. Miles
Chief Investment Officer

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