HUSIC CAPITAL MANAGEMENT

INVESTMENT OUTLOOK

<u>Fourth Quarter 2008</u>

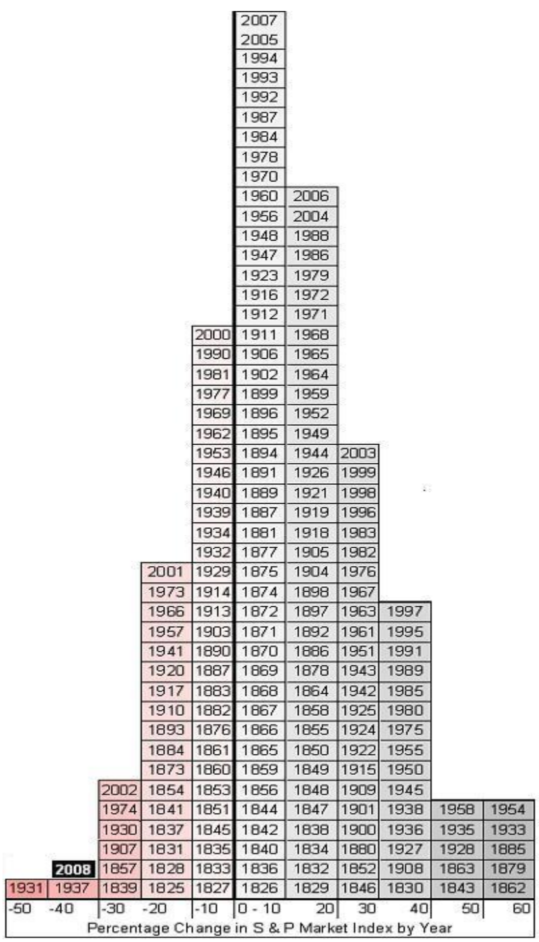
Where are we now?

The most important tailwind of the decade was the industrialization of the emerging world. We are shocked and disappointed that authorities were slow to realize the extent and severity of credit problems in the U.S. The assertions that "the economy is fundamentally sound – this is just a containable subprime problem" clearly were incorrect. If they had seen it sooner, they could have averted what has subsequently happened.

Further mistakes, especially allowing Lehman Brothers to go bankrupt, precipitated the global recession we are now experiencing. In the end, the 2008 performance of the Standard and Poor's 500 Index was one of the worst since 1825.

We have been through the "100-year flood." It has been a rapid, vicious cycle: returns weaken, volatility spikes, forced selling occurs and the angle of decline accelerates. The S&P 500 Index had a horrible 2008, declining almost 40%. Let us put that into perspective using the table below, which shows S&P 500 Index historical annual returns since 1825.

Percentage Change In S&P 500 Index Per Year



Source: www.boingboing.net

In 184 years, a decline in the index of over 30 percent has only occurred three times, or less than two percent of the time.

Over 80 percent of the time, the returns have fallen between a 20 percent decline and a 30 percent gain. By the end of the third quarter 2008 the index was down 20 percent. Thus the probabilities would indicate that the markets had discounted the bad news and a rally would ensue.

Other indicators including the volatility index -- or VIX -- supported this view as well. This contrarian indicator that had traded in a range of 20 to 30 for more than the past year spiked to almost 50. Prospects for a soft landing looked promising with valuations reasonable and global economies continuing to grow, albeit at lower rates. Then the Lehman Brothers bankruptcy froze the markets.

Alternative investments gained much of the asset flows this decade. The challenge is that most of the money ended up in highly illiquid instruments such as private equity and real estate. Over-levered hedge funds and financial institutions needed to raise cash rapidly to meet margin calls and redemptions, so they sold what they could, not what they wanted. Thus publicly traded equities were sold en masse.

To analogize the impact on the stock market, think of a heavy ball crashing into a pool of water. Like the displacement of water, stocks fell at an accelerated pace as buyers disappeared or fled. The impact was severe at first. Thus we saw the extreme volume and number of new lows in October on the initial plunge. Then authorities declared they were "all in," and accelerated their use of all the tools in their arsenal to save the system.

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Interestingly, on the November retest, volumes were lower and new lows were half the previous levels. The VIX, which spiked to an unheard of 90 in October, was only at 81. Despite continued bleak headlines, the market internals were improving.

As predicted in prior installments of "Outlook," horrified authorities are employing every fiscal and monetary lever to reverse course. No one can be sure whether these will be successful. We are optimistic and hopeful. Regardless, we are sure the economic world will be changed forever and that there will be major unintended consequences, both bad and good.

So we find ourselves in the unattractive situation of dependence on action by the government, an unpredictable and often illogical entity. One example is the Troubled Assets Relief Program (TARP), which was set up to buy toxic bank assets, the goal being to combine TARP with capital infusions to recapitalize the banks. Secretary of the Treasury Henry Paulson then changed his mind on using TARP to buy toxic assets. Thus, continued writedowns are depleting bank capital, resulting in a fear of bank nationalization and wiping out banks' common shareholders. Confusion is the worst issue for investor psyches.

We especially believe the mismanagement of economic affairs during the fourth quarter has generated an atmosphere of fear and trepidation. What is required is a return of confidence globally. Though we are not sure what will bring it back, the opportunity is surely there with the arrival of new leadership in Washington.

We believe valuations in the equity markets are among the most attractive in years. However, given the prospect of declining profits, it will take a change in consumer and investor psychology to bring a stabilization of prices and a normalization.

Outlook: Is The Worst Behind Us?

As the authorities stepped in to aid the credit markets, these markets started to thaw. The three-month London Interbank Offered Rate (LIBOR) is below 1.5%, well below its peak above 5%. High-grade corporate versus U.S. Treasury spreads have started to recede, as have other credit spreads. Mortgage rates have broken below 5%, which is a substantial plus for restarting the crucial real estate market.

Following the November bottom at 741, the market has rallied sharply to 943. That is a 27% rally in five weeks. We are now in a correction from a strongly overbought condition. Early in 2009, we have seen another retest of the lows with further improvement in market internals. Though historically still at an elevated level, the VIX is back down into the 30s, indicating the fear is abating. Reviewing the heavy ball in the water analogy, we believe that the "ball" has reached a nadir. Though the bottoming in the markets may not be as simple as our ball-in-the-water analogy, the process to date is constructive.

We are working with a new theme that will become an important part of our portfolio this year. We have not yet honed this theme but it will involve companies that are in the path of the huge wave of spending by the government. Potential sectors include infrastructure, basic materials and clean energy, to name a few.

Our goal is to sell shares in sectors being harmed by government intervention and to buy the beneficiaries of it. In addition, we continue to search out opportunities that will benefit from the economic recovery.

In conclusion, we should expect volatile markets as sentiment oscillates between hope and despair depending on data, policy moves and speculation. This will require a strong hand on the tiller, to borrow a nautical analogy. We will set our course and use our hurdles to keep us on track.