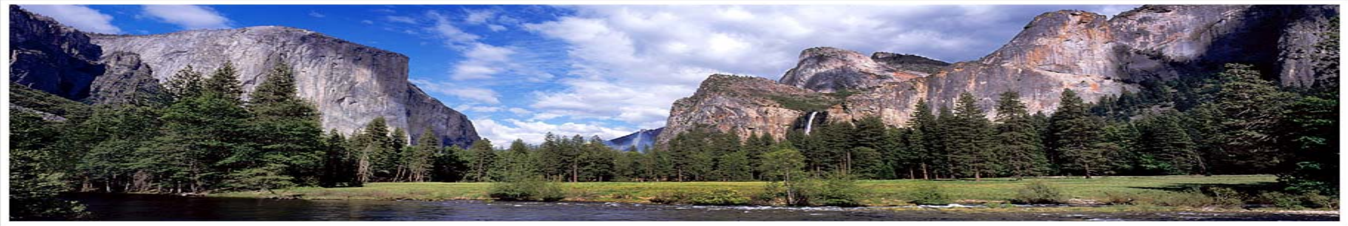

YOSEMITE CAPITAL MANAGEMENT

First Quarter 2010 – COMMENTARY

"Bad times have a scientific value. These are occasions a good learner would not miss."
– Ralph Waldo Emerson

The economy continues to slowly repair itself, enough so that the federal government is already laying the groundwork to unwind at least some of the stimulus programs implemented during the 2008 Credit Crisis. We believe ***the odds favor a continued but muted recovery***. The economic cycle reached a point of extreme and then began to revert as participants responded to the situation, just as has happened throughout history. Today's situation is not clean, not pretty, and fraught with many questions and risks – in short, far from normal – but the classic process in general continues to occur:

> **Corporations** have largely curtailed their operations to a level appropriate to a severe recession and are, perhaps anxiously, ready for a return to growth
>
> **Inventories** have been reduced to minimal amounts and are ripe for rebuilding
>
> **Capital** (whether via equity issuance, bonds, or loans) is gradually being made available, even if only to the most creditworthy businesses and consumers
>
> **Consumers** have been and continue to be deleveraging, which means cutting back on debt and returning spending to levels more appropriate to their means (more on this below)

We caution, though, that ***the pace of recovery could remain painfully slow for a long period*** of perhaps several years due to the severity of the wounds Americans inflicted on the economy (excessive borrowing, inappropriate spending, inattention to risk, etc.). In our view, this is not a standard inventory recession that can be mitigated with "proper" stimulus. Rather, this is a credit crisis that is much more difficult to contain and repair, which is why monetary and fiscal stimulus has not been more effective. A problem brought about by excessive borrowing and low interest rates cannot be cured simply by more lending and low interest rates! A sluggish recovery could potentially exhibit elements like stubbornly high unemployment, sub-par corporate earnings growth, mixed economic reports (some positive and some negative), volatility in financial markets (especially stocks), and constant concerns. These in turn could cause great angst for and provoke incessant bloviating from talking heads, fear mongers, politicians, and other unimportant people.

There are various potential impediments to future growth. How these are resolved could significantly affect the pace of the recovery. We believe that even the very existence of the recovery is at stake because if these concerns get out of control the economy could relapse into an oft-mentioned "double dip" recession. Such impediments include:

Consumer Deleveraging could be a multi-year theme
A prolonged period of consumer deleveraging seems to be unavoidable given the extent of debt incurred. The potential bright side is that consumers might be close to finishing major cutbacks in lifestyle spending, assuming no additional shocks occur.

Government Stimulus Programs will eventually be removed, in our opinion, and some areas of the economy that depended on this may decline if these programs were the *only* reason for any growth or even stability (think autos and the low end of the housing markets as possibilities)

We feel that a removal of at least some government stimulus programs is a given in the next year or so. But just as a young bird makes its first attempt to fly from the nest it is practically impossible to predict either a successful flight or a death plunge until the jump is actually made. We doubt the programs will be terminated in rapid order and doubt significant additional removal if any death plunges were to happen.

Residential Real Estate has the potential for another wave of mortgage recasts in 2010 and 2011, delinquencies are rising at the high end and among prime borrowers, any hint of price stability brings shadow inventory onto the market, and activity at the low end is driven significantly by foreclosures and supported by temporary tax credits

Housing prices have fallen far enough to be at least in the upper end of "normal" valuation ranges by such metrics as Price-to-Rent and Price-to-Income. Being at the upper end of a valuation range argues that prices could still fall further without a particular reason and contribute to economic problems. Even so, the bulk of the damage caused by falling housing prices could already be done in many markets across the country, we believe that prices are closer to their ultimate bottom, and thus the downtrend in prices could be at the beginning of the end. The economy might be able to grind along during the final stage of this process, though growth at a consistently strong rate is unlikely to occur until residential real estate prices finally reach their nadir.

The Financial System remains significantly unrepaired in our perception, as too many bank balance sheets remain cluttered with toxic assets (hard to believe TARP was originally intended to facilitate removal of such items!), assets are still marked-to-make-believe instead of marked-to-market (meaning the true health of some companies is potentially overestimated while risks are underestimated), and no substantial reform is occurring to prevent companies from causing systemic risk.

The true status of the financial system is practically impossible for anyone to fully know for certain and therefore be able to assess how close we are to systemic problems. Let's suppose the bailouts worked to keep the global financial system from collapsing into the abyss and the *components are on their way to operating in a somewhat normal manner. As asset prices recover and financial companies take actions to pare their risk exposures, their balance sheets as stated get closer to reality and the firms get closer to functioning properly. However, thanks to a lack of transparency outsiders are not permitted to know the extent to which this is happening, how much more must be done, and whether or not there still remains a serious chance of systemic problems in the near term. There is always uncertainty about the future, but this problem extends beyond mere uncertainty and, in our view, is part of the reason that substantial reform is necessary.*

While there can be legitimate differences in opinion as to what reforms are necessary, we lament the regulatory capture that large financial institutions or trade groups have in place over Congress and regulators that stifle almost any real reform. Perhaps there is an attitude of "we're sorry and we won't do it again", but there seems to be nothing forthcoming that will go a long way to preventing more bubbles and bursts, especially those caused by manipulation and willful disregard for risk. Even if it's the case that for now there is nothing to fear about more systemic problems, we wonder whether in a few years there will be yet another crisis that could have been avoided with appropriate action today.

As we stated at the beginning of this letter, we believe ***the odds favor a continued but muted recovery***. However, there are risks that we cannot and will not ignore, especially the concerns about residential real estate and the functioning of the financial system affecting the economy and financial markets. We remain optimistic but vigilant, believing that managing risks is as important as managing returns.

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