YOSEMITE CAPITAL MANAGEMENT

First Quarter 2011 – COMMENTARY

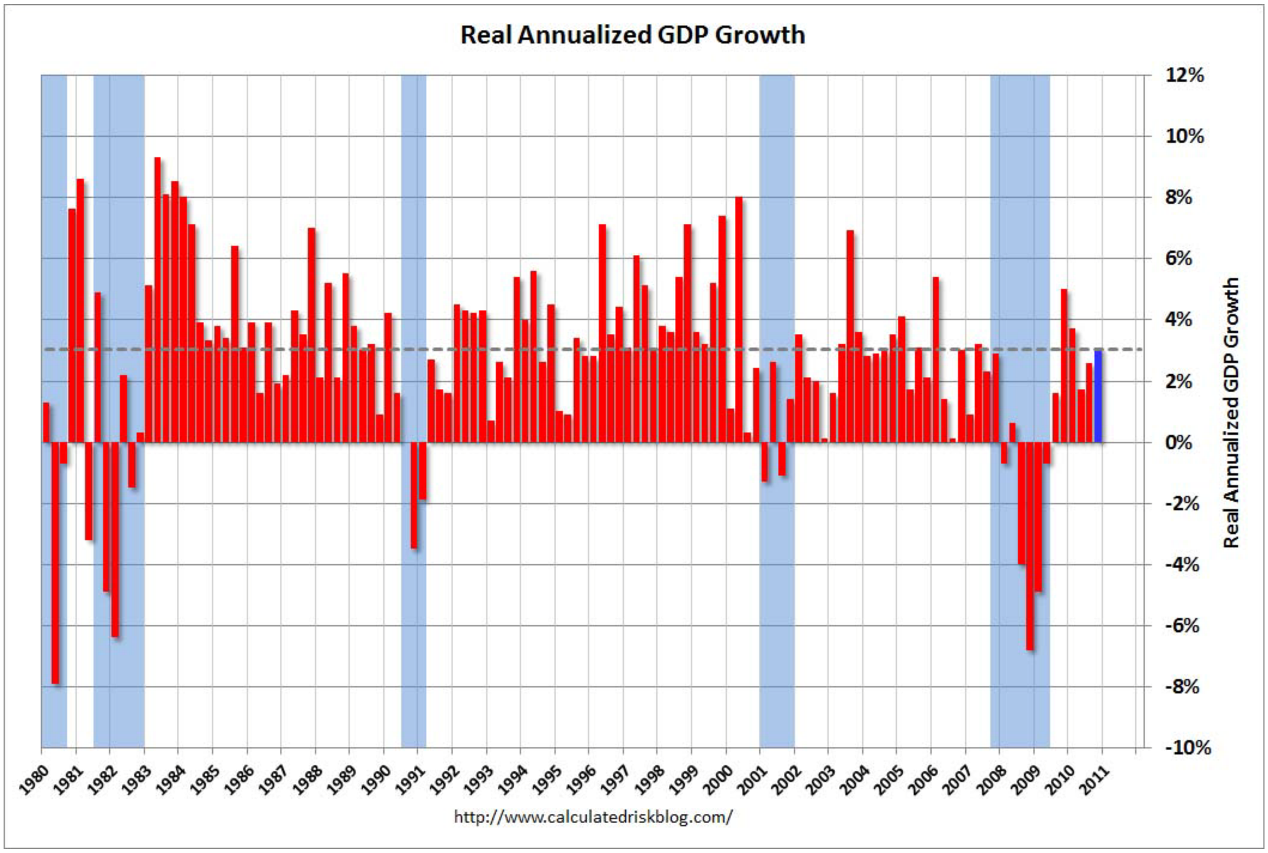
Since common stocks, even of investment grade, are subject to recurrent and wide fluctuations in their prices, the intelligent investor should be interested in the possibilities of profiting from these pendulum swings. – Ben Graham

The economies of the developed world continue to recover from the credit bubble and bust. Due to the serious nature of the wounds to the economy and the financial system, the healing has been and likely will be slow and choppy. In large part this stems from the fact that the residential housing markets and the financial sector are still nowhere near their normal operating functions. However, the key point is that while sluggish, we believe growth will be *positive*. The thesis we made in our First Quarter 2010 letter remains intact.

Because of a recovery that continues to generate mixed signals, the financial markets remain vulnerable to even hints of bad news, whether real or imagined. As such, we expect the markets to continue to experience periods of volatility. Given that we perceive positive economic growth and conditions that are somewhat favorable to the financial markets (valuations are not excessive, corporate earnings growth continues, inflation remains subdued for the time being, etc.), investors should take advantage of any drops in prices.

Additionally, we perceive there is latent demand for securities. Many investors, both professional and amateur, have cash to invest. Many workers have delayed retirement because they have not saved enough to retire and need to bolster their investment accounts. The possibility of inflation is a concern for more than a few, and if this is to become a reality of any sort, cash will need to be put to work. In short, there is a lot of money that is or will be looking for a home, whether in stocks, bonds, commercial real estate, commodities, etc., especially as more become convinced the economy is improving.

While no two years are ever the same, a look back as recently as last year can be instructive. Domestic GDP growth in late 2009 tapered off from an annualized rate of about 5% to less than 2% in the second quarter of 2010, according to the U.S. Bureau of Economic Analysis. This is illustrated in the chart below, which provides a 30 year perspective:



Source: Calculate Risk, March 25, 2011

This slowdown, in conjunction with the end of the Federal Reserve's first Quantitative Easing program, contributed to a global stock market decline that anticipated the result from late April to early July. Amid fears of a double-dip recession, the decline proved to be an opportunity for investors as evidenced by the S&P 500, which had been negative for the year at its low point and then rallied substantially to ultimately provide a good return of about 15% in 2010. This experience typified what we mean by slow and choppy growth and how financial markets can react to such circumstances.

A repeat of this general sort of activity would not surprise us in 2011, with varying levels of GDP growth and market volatility. As of this writing in late March, the S&P 500 has already had a 7% decline. Given the apparent swift bounce back, one might be encouraged that the drop was not more considering the global backdrop of the terrible natural disaster in Japan, revolutions and political unrest in north Africa and the middle east, and financial turmoil in some European countries. Whether these or any other events will cause the March decline to be just a prelude to something worse is anybody's guess. But that's part of our notion that the direction or extent of specific moves in the financial markets are not predictable on a consistent basis. Regardless of causes, we remind investors that stock market declines of more than 5% are *normal* as they occur *on average* about twice per year and declines of 10% or more are also *normal* as they occur *on average* about every 18 months, according to Ned Davis Research.

We continue to warn investors to temper their expectations for returns from the financial markets. The halcyon years of the 1980's and 1990's are not likely to return any time soon. But realistic expectations, coupled with investing discipline that includes not only accepting but actually embracing market volatility, in our opinion will far more likely meet investing goals. With a focus on risk management, we remain watchful of opportunities and pitfalls while we monitor the various financial markets and the economy.

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The S&P500 Index is designed and maintained by Standard & Poor's (a division of The McGraw-Hill Companies), is a free-float market capitalization weighted index that includes 500 leading companies in leading industries of the U.S. economy, and is intended to be an ideal proxy for the total market. This index is calculated on a total return basis with dividends reinvested and is not available for direct investment.