COMMENTARY

September 10th 2008

Dear clients and colleagues

Earlier this week, I attended the Lehman Brother's financial services conference. It is the largest such conference, with over 100 companies presenting and 4000 investors attending. The timing was interesting as it started on the Monday following the decision by the US government to put Fannie Mae and Freddie Mac under conservatorship. It also coincided with Lehman's own survival in doubt.

We had a chance to meet many financial companies in the portfolio as well as hear what large institutions such as Wachovia, Credit Swiss, Blackstone and others had to say on the current market conditions.

What did we come away with? On the US residential real estate front, most speakers were expecting further declines, probably until mid-year 2009 and then some stabilization, no v-shape recovery. The arguments for such a scenario were the following: The inventory of unsold homes as decreased significantly in the past year. The own vs. rent relationship has narrowed, making ownership attractive again. The number of new household expected to be created in the US in the next 5 years (over 20 million new households) will create additional demand. We are cautiously optimistic that the worse might soon be over. Often, when we buy out of favor stocks such as Lennar, one of the largest US homebuilder, we like to go back and review the reasons that were given by the company and analysts to buy the stock when the stock was selling at a record price, in the case of Lennar, $69 vs. the current $13. Often, many of these reasons are still valid today, although the street now tends to only concentrate on the negatives. An important thing however is to not buy the first few corrections and wait for the capitulation. This is why we would not necessarily buy more in the materials and energy sectors right now.

Now the bad news, although Banks now seem sufficiently provisioned for more residential real estate losses, they have nowhere near sufficient reserves for the other shoe poised to drop, that is commercial real estate and consumer debt, i.e. credit cards, auto loans, etc. In our opinion, this is the major risk right now and the reason why we continue to be cautious about the US financial sector.

We own a few US regional banks in our portfolio, stock selection is key. First Midwest (FMBI) in the Northeastern Illinois area, UCBH (UCBH), a San Francisco based bank serving the Chinese American community in California and also owns a Bank in China and City National, a California based bank serving the mid-market.

City National Corporation (CYN:NYSE), www.cnb.com Market cap, $2.75 Billion, P/E 15.3x, Yield: 3.3%, Expected growth: 15%, Total assets: $16.3B, AUM, $33.8B, 1year return: -15%.
City National delivers banking, trust and investment services through 62 offices in Southern California, the San Francisco Bay Area, Nevada and New York City. The company provides complete financial solutions for individuals with $1 million or more of investable assets - a market of more than 500,000 California and Nevada households - and small and mid-sized companies with annual revenues of between $1 million and $250 million. (1)

In City National, we own a Bank that is operating in some of the fastest growing and most affluent areas of the US that is well diversified and may benefit from the fallout of larger banks. In the last quarter, average loans grew at a 12% annualized rate and core deposits grew at 16%. The Bank has no subprime loans, no subprime CDO's and no liquidity crisis. The Bank's problem is mainly with construction loans to homebuilders but in our opinion, reserves are sufficient. In addition, the Bank has a solid asset management business with over $33B in AUM, which now represents 22% of the revenues. We believe that earnings will be $6 in 2010, our target price is $90, a 60% return including dividends.

(1) Source: Company web