

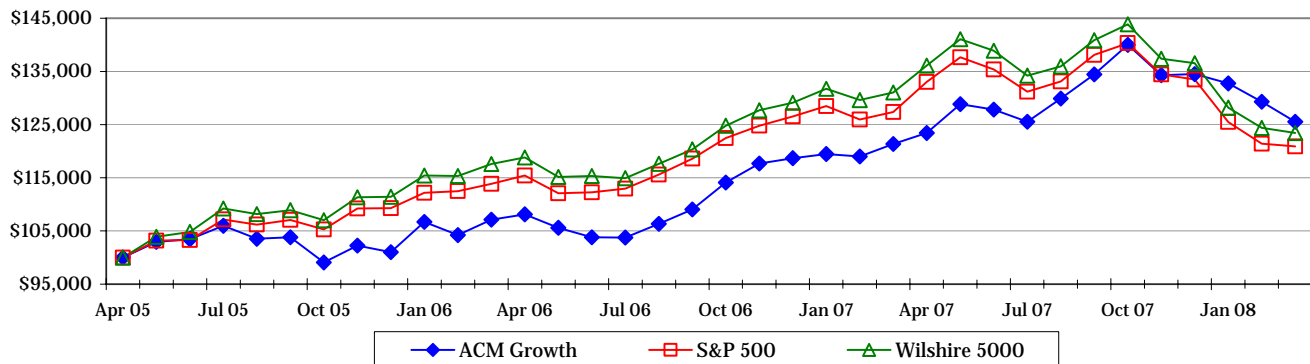


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Growth Performance

Performance as of 3/31/08	Year to date	1 year	2 years	Since inception (4/30/05)
ACM Growth	-6.66%	3.42%	17.17%	25.52%
S&P 500	-9.44%	-5.08%	6.16%	20.89%
Wilshire 5000	-9.61%	-5.83%	4.95%	23.42%

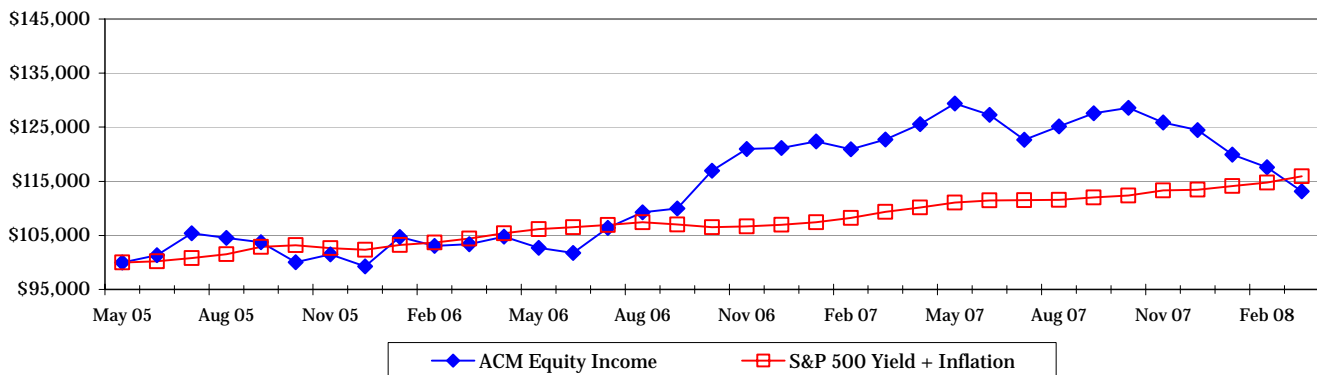
Comparison of the change in value of \$100,000 investment in ACM growth versus S&P 500 and Wilshire 5000



Equity Income Performance

Performance as of 3/31/08	Year to date	1 year	2 years	Since inception (5/31/05)
ACM Equity Income	-9.12%	-7.81%	9.46%	13.13%
S&P 500 yield + inflation	2.20%	6.03%	11.05%	15.93%

Comparison of the change in value of \$100,000 investment in ACM equity income versus S&P 500 yield plus inflation



Past performance is no guarantee of future results. As in all equity investing, there is a risk for potential loss. Performance results were calculated after deduction of all management and trading fees. Portfolios were valued daily, trade date accounting was used, accrual accounting was used for dividends. Time-weighted rates of return that adjust for significant cash flows were used. Returns from cash were included. For ACM growth accounts, the S&P 500 was used as benchmark because it was deemed the most readily available and widely known growth composite. It should be noted that ACM growth accounts were more concentrated, sometimes had higher cash investments, included international investments, and were invested in companies with different market capitalizations and characteristics than the S&P 500. Although these differences existed, the accounts shown were invested for growth and not set to achieve any particular market capitalization or exposure. ACM equity income accounts used S&P 500 yield plus inflation because this combination of the most readily available equity yield and growth with inflation was deemed the most relevant benchmark for equity income accounts. These accounts are designed to provide an equity yield for income plus growth to maintain purchasing power over the impact of inflation. Both out- and under-performance of accounts shown were due both to individual security selection and to concentration of investments. Neither market nor economic conditions contributed significantly to account performance. ACM growth and equity income portfolios include all portfolios under management during all periods of management and include portfolio performance as of the first day of management. The accounts depicted used no leverage or derivatives. The S&P 500 and S&P 500 yield plus inflation returns shown do not reflect commissions, trading expenses, or management fees, which would have reduced both benchmarks' results.



Athena Capital Management

April 16, 2008

Happy Spring! As I mentioned at the end of last quarter's letter, I'm making the client letter shorter by eliminating the *Why is...* and *Admirable Business People* sections. This will allow more space to write about our holdings and where I think things are going.



This letter will include a review of how we're doing, an update of my 6 year market projections, a review of how investor psychology can hurt your results, and an investment spotlight on Comcast.

How Are We Doing?

Growth accounts performed relatively well this quarter despite market turmoil. We're down less than the market, but this provides little comfort in the short term. Let me just say that losing less provides excellent results when the market does recover.

Although our investments did very well in January and February, they didn't fare as well in March, when a return to risk taking seemed to benefit junkier businesses. I don't believe this will last, though, and remain very confident about our long term results looking forward.

Growth accounts generated out-performance from **Wal-Mart** and **USG Corp.** Wal-Mart's plan of sticking to its low price strategy, opening fewer stores domestically, expanding internationally and buying back shares is beginning to pay off. USG (the largest supplier of gypsum wallboard in the U.S.) climbed more rapidly than the market as investors began anticipating an end to the housing slump. I doubt housing problems are over, but I'm quite confident USG's fundamentals will do very well as housing and the economy recover.

Growth's under-performers included **Microsoft** and **UnitedHealth.** Microsoft offered to buy Yahoo! and the market didn't like it. Regardless of whether Microsoft's bid succeeds, its future looks bright in terms of software sales over the next 5 years. UnitedHealth declined due both to New York's investigation into health insurers and because the whole industry seems to be suffering from lower enrollments and higher expenses. Despite these problems, I believe UnitedHealth's superior technology platform and flexible plans will provide superior earnings growth over the long term.

Equity Income performance this quarter was poor. Although our companies continued to raise

dividends and post strong performance, this didn't overcome the market's short term, negative focus on real estate and finance companies. Although these results are disappointing, I also think they're temporary. Our concern is permanent loss of capital and dramatic cuts in dividends, neither of which have occurred. I believe our future performance will vindicate my view that this episode is a temporary, though unpleasant, diversion.

Equity income accounts saw out-performance from **Park National** and **Kimco Realty.** Park National rallied as the stock market recovered and as investors began to realize that some financial institutions are better run than others. Kimco, too, recovered with the market and when investors concluded that not all real estate companies are as high quality as Kimco.

Equity income's under-performers were **Merck** and **iStar Financial.** Merck came under increasing scrutiny as a study showed Vytorin is no better at treating cholesterol than cheaper generic drugs. I believe Merck's growing pipeline of drugs will, in time, justify a higher stock price than at present. iStar continues to get grilled for being at the crossroads of real estate and finance. Despite its recent price decline, I continue to see significant value in their specialized commercial real estate finance platform.

6 Year Market Projections

The S&P 500 had yet another volatile quarter, down as much as 14.4% at one point, before finishing down 9.5% for the quarter. My 6 year projections for the market look better, but still significantly below returns over the past 20 years. I expect our investments to continue to out-perform over the long run, but the path is likely to be bumpy.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	-3.8% to 8.4%
S&P-500-yield-plus-inflation (equity income benchmark)	3.7% to 6.7%

How do I arrive at these numbers? Visit "Free Articles" at www.athenacapital.biz to see my 7/12/05 article.

The economy may finally be entering a recession. Employment and factory data seem to support what the housing and financial markets have been saying since last year. Because of the central part housing and finance plays in our economy, this recession may be longer or deeper than the past two recessions.



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The Federal Reserve and U.S. Treasury are working hard to fix our economic problems.

Unfortunately, this almost always comes at a price, so expect higher inflation and interest rates when the economy begins to recover. I've been preparing our portfolios for such a possibility for the past 3 years.

Stock market and economic recoveries are notoriously difficult to predict. For that reason, I'm not trying to. Instead, I'm positioning our portfolios to thrive in whatever economic environment we find ourselves.

I'm finding wonderful bargains for our accounts and am increasingly optimistic about our returns over the next 3 to 5 years. **If you have any additional money you'd like to invest, this is a good time to do it.**

Investor Psychology

The S&P 500 provided 12.2% annualized returns from 1983 to 2002 (Dalbar, 2003), but **the average mutual fund investor received returns of just 2.6%** (even less than inflation over that time: 3.1%)!

How, you might ask, is that possible? **Investor psychology caused people to buy high and sell low.** Instead of buying and holding, most investors chased performance—buying things that had gone up and selling things that had gone down.

In 2000, Bob—my name for a typical person subject to investor psychology— sold “old economy” stocks, like Caterpillar, because it was down 40% and bought “new economy” stocks, like Cisco, because it was up 140%. Eight years later, Caterpillar is up over 200% and Cisco is down 67%—OUCH!!!

To help you prevent such outcomes, I'll describe how investor psychology creates traps and how poor Bob falls into them, and then some tips on how you can avoid such traps yourself.

Bandwagon Effect

Bob, poor guy, bought Apple at \$200 because everyone else was. He didn't buy because he understood Apple or its worth—he bought to avoid “missing the train” everyone else was on. **Following the crowd without independently examining the merits of the**

crowd's direction is referred to as the bandwagon effect.

The way to avoid this problem is to think independently. As your mother said, “If everyone jumped off the Brooklyn Bridge...?” Bob should ask himself if he *really knows* Apple is a good buy, or if he's just feeling compelled to join the crowd. Such a gut check could save Bob a lot of money over time.

Overconfidence

A 1981 study of automobile drivers in Sweden showed that 90% described themselves as above average drivers (even though it's only mathematically possible for 50% to be above average). Such research shows how many of us overrate our abilities. Bob was overconfident, and probably over-estimated his understanding of Apple when he bought it at \$200, too. **The tendency to have an inflated estimate of our own ability is called overconfidence.**

To prevent this trap, get a second opinion and wait until your target is selling 30% below what you think it's worth. Bob should find a reputable source to compare his estimate of value against. Morningstar's stock analysts do a fair job of this, or he could ask for my opinion. In addition, Bob should wait to buy Apple at \$140 if he thinks it's worth \$200 to provide a 30% margin of safety ($\$200 \times 70\%$).

Anchoring

Bob bought Apple at \$200 a share and mentally “anchored” on that price when it declined to \$120 a share. Although he knows its price has fallen, he still thinks Apple is “worth” \$200. **Bob demonstrates anchoring, the human tendency to rely too heavily on one piece of information.**



Bob must realize that the price he paid is not always equal to what the stock is worth. **Instead, he should use an absolute standard for evaluating worth.**

For example, he could use the price-to-earnings or price-to-book ratio. Or, he could consult an expert, like Morningstar's stock analysts, or me.

Loss Aversion

If Bob buys Apple at \$200 and it drops to \$120, he'll probably tell himself he won't sell until it “gets back” to



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\$200. But, this thinking won't help if he ends up selling it at \$75—or if he has to wait several years for Apple to get back to \$200—thus missing alternative high return opportunities. **People hate losing a dollar much more than they love gaining a dollar—that's loss aversion.** It makes sense why people hate to lose money, but such over-emphasis on losses leads to bad investment decisions.

The best advice? Forget the past, and look at your investments less frequently. Bob shouldn't dwell on the price he paid for Apple. The market doesn't care what price he paid, it only cares what something is worth in the long run. Nor should Bob check Apple's price daily. Stock prices are random in the short term, so Bob could make bad decisions—feeling euphoria on up days and destitution on down days—if he checks price too frequently.

Hindsight Bias

Bob *knew* Apple was going to soar once it passed \$100, or at least that's what he'll tell himself after it climbs to \$200. **The inclination to see events that have already occurred as more predictable than they were, in fact, is called hindsight bias.**

The best way to defend against hindsight bias is to write down your predictions beforehand and compare them to what happens. If Bob writes down his predictions for Apple on paper, he can compare his ability to forecast to what actually happens, instead of erroneously “remembering” how right he was afterward.

Conclusion

The vast majority of people get lousy investment results because they fall into psychological traps. But, if you know the traps and follow the solutions highlighted above, your results will benefit tremendously.

A simpler solution—and the one you made in hiring me—is to **put such decisions into someone's hands you trust.** Although imperfectly, I work hard to avoid these traps and I believe my long term results reflect this effort.

Investment Spotlight: Comcast

Few companies are hated as much as cable companies. Their service is terrible—“we'll be there between 8 am and 5 pm.” Their prices are high and seem to rise every year. Customers can't order just

the channels they want—they must order a “bundle” including unwanted channels. Despite these negatives, cable companies have competitive advantages that make them cash machines, and Comcast is the biggest and most successful cable company by far.

One aspect of Comcast's growing cash machine is the rollout of the triple play—the ability to offer 1) digital TV, 2) broadband internet and 3) phone service through one landline. And, digital cable is no longer just a bunch of channels; it now includes video on demand, digital video recording, and high definition programming—*additional* revenue streams! Comcast also offers businesses the triple play, creating yet more revenue.

Although the triple play sounds like a slam dunk, Wall Street is worried because **Comcast is spending a lot of money to build it out.** What Wall Street may be missing, though, is that the initial cost of setting up customers with the triple play—things like new set-top boxes and marketing—will not go on forever. After Comcast spends this initial money, it will have 3 revenue streams over the same equipment it had but 1 revenue stream before. This provides Comcast with very high incremental returns on capital, meaning: the more they spend now, the more they make in the future.

Let me give you an example to illustrate this last point. Comcast spends \$300-\$400 to purchase set-top boxes that go into a customer's home. On average, Comcast generates an additional \$7-\$14 a month from customers with new set-top boxes. That means Comcast is earning \$84 to \$168 a year for spending \$300 to \$400, *once!* **That's a 21% - 56% return on invested capital in the first year!** That's a return profile most companies can only dream of.

To top it off, Comcast has excellent management. **Comcast's team includes Ralph and Brian Roberts, the father and son that built the company from scratch starting in Tupelo, Mississippi.** This team has always focused on long term value creation instead of short term results, much to Wall Street's chagrin. Insiders at Comcast own \$486 million worth of company stock, so they tend to act as trustees of shareholder wealth.

Add it all together, and you have a company with **great economics and management trading at an attractive price.** Comcast may have mediocre service, seemingly high prices, and “bundled” channels, but it also has growing revenue in new markets, high incremental returns on capital, and a management team eager to translate these traits into a rising





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share price. If my projections are correct, you may learn to love cable, too, despite its shortcomings.

Until next quarter

Thank you for choosing to do business with me.

I'm happy all growth accounts are beating their benchmark, and optimistic equity income accounts will bounce back soon. I can't control short term results, but I have positioned our portfolios to do well in the long run, and look forward to reporting on our progress.

Athena continues to grow with new clients and contributions from existing clients, and **I'm still seeking new clients who can benefit from my investment approach.** If you know anyone who might be interested in my services, please send them to my website and blog and provide them with my contact information.

Until next quarter, enjoy the greening of spring and warmer weather. I look forward to hearing from you throughout the quarter.

Michael Rivers, CFA
Athena Capital Management
370 Waco Court, Colorado Springs, CO 80919
719-761-3148, mike@athenacapital.biz

If you want to see my thinking about investing and the economy in between letters, visit my blog:
www.mikerivers.blogspot.com