HOLMES R. OSBORNE III, Inc.
A BETTER WAY TO MANAGE MONEY
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Rocky Quarter

The year started off strong and then fell 416 points on February 26. At the time, almost nothing was making money. Investors were spooked about China, the real estate market, and more recently, sub-prime lenders. However, the market is up about 1% since the beginning of the year. Volatility is to be expected. We have experienced one of the least volatile times in history. It had been almost 1000 trading days since a major drop.

When times get shaky, I ask myself one question, "Is Mercury Auto Insurance going to keep selling auto policies, and is Apache going to keep pumping for oil?" If the answer is yes, then we are okay.

John Bogle's Little Book of Common Sense Investing

John Bogle, founder of Vanguard, came to Los Angeles last month to speak at Pepperdine and the Chartered Financial Analysts' Society. Mr. Bogle is famous for the Vanguard 500 Index Fund.

Mr. Bogle's investing thesis is that when counting fees and taxes, it is difficult to outperform the indexes, and that only a few managers have ever been able to do it consistently. That is no doubt true, but they are several reasons why I don't want my clients' assets in index funds.

The first reason is that it makes one entirely dependent upon the overall health of the economy. If the fund owns 500 stocks, then it will be affected by macroeconomic events. Futhermore, as the Babyboomers age, I think the economy is going to slow and that is exactly where I *don't* want my clients' money. I would rather concentrate on industries that I think will do well in a slowing economy, or in countries that look favorable to American investors.

In Bogle's last chapter, he writes when you should invest with fund managers. "But only if they are run by managers who own their own firms, who follow distinctive philosophies, and who invest for the long term, without benchmark hugging. Don't be disappointed if the managed fund loses to the index fund in at least one year of every three!" I would agree with this passage.

Fund managers who own their own firm have less conflicts of interest to worry about and do not have too many people interfering with their management. Benchmark hugging is when investors try to match how the index is invested. I definitely do not do this. Some accounts have 46% invested in insurance stocks. Also, he mentions "distinctive philosophy". My philosophy is to buy stocks at big discounts. He also said invest for the long term. Many clients are invested in stocks that I plan on holding for many years to come.

Apache

We were forced to sell **HMA** because management decided to institute a poison pill. A poison pill is when management takes an action to make the company look unattractive to corporate raiders. In this case, HMA pilled on a bunch of debt. Unfortunately, it was also unattractive to long-term shareholders.

We took the proceeds and invested in **Apache** Oil. Apache is an oil explorer with wells in Texas, U.K., Australia, Egypt, and the Gulf of Mexico. The stock has been quiet since oil has pulled back. I think it will do well if and when the price of oil rises. I can't imagine an environment where oil does not rise considering the problems in the Middle East and the ascent of China.

Pogo Oil

We also sold our shares in **Capital Lease Funding**. **LSE** is a real estate investment trust that is the landlord to the likes of Best Buy, Circuit City, and other blue chip companies. It made about a 12% profit in a year but we had to make room for **Pogo Oil**.

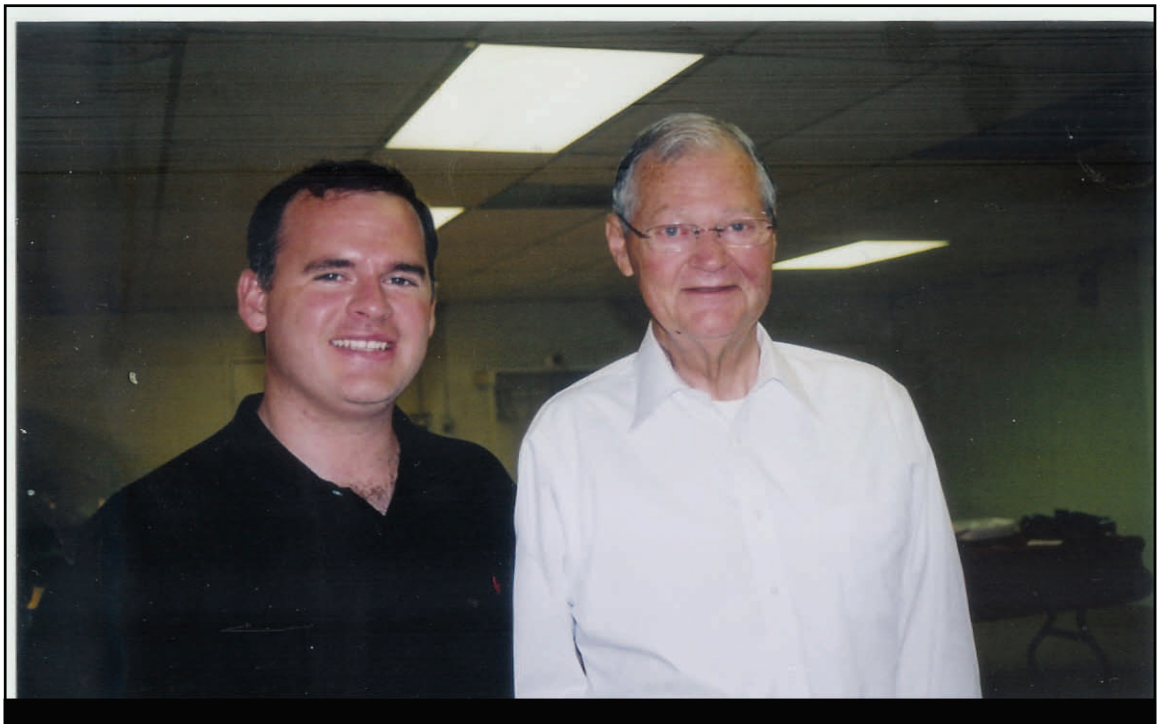
Pogo is an oil explorer very similar to Apache. However, Pogo has not partaken in the oil boom because of some internal problems. An activist hedge fund named Third Point bought shares and forced management to place two people of their choice on the board. Perhaps Third Point can help management turn things around or sell the company and we can make a profit.

Real Estate

I have been writing about how I think the real estate market is going to pull back since 2004. It has not happened quite like I planned but it has definitely dropped in some areas and slowed in almost all parts of the country. I thought that it would be down much more at this point when I began writing on the topic in 2004. You might remember apartment REIT **United Dominion Realty** which we bought and sold back in 2005. UDR made clients a nice profit when investors recognized this industry as a profitable alternative to the housing market.

The subject du jour is sub-prime lending which is when banks lend to people with FICO scores below 700 or who offer little financial information. California is a hotbed of sub-prime and other lenders. Some of the sub-prime lenders include Fremont (here in Santa Monica), New Century (now bankrupt), and IndyMac in Pasadena.

It will be interesting to see how this plays out. I will be attending Fremont's shareholders meeting in May to investigate in more detail the industry but will almost definitely not invest in Fremont. Though I have said for a few years that this segment of the loan industry would fall first, I think that things are overblown. Most loans are traditional with money down and people with a history of making their payments.
As always, when there is bad news, I become very interested in hunting for a bargain.



Holmes Osborne Meets House Armed Services Chairman

Last summer, I had the opportunity to meet Congressman Ike Skelton, chairman of the House Armed Services Committee. Congressman Skelton has represented my old district in Missouri since 1976. It took him precisely 50 years to ascend from Prosecuting Attorney of Lafayette County to the position he holds.

Mr. Skelton has made himself an expert in military knowledge. Though he had polio as a young man and could not serve in the military, he has spent decades studying old battles, world history, and our military. Mr. Skelton was one of the first people to point out that our Humvees had too little protection years before it became a controversy.

Congressman Skelton's and my family were part of the original settlers in Missouri and have been in the same county ever since.

Reminder to clients

Please mail checks and retirement contributions to Fidelity, P.O. Box 5000, Cincinnati, OH 45273-8007

Mercury General's shareholder meeting is 10:00 a.m. is on May 9, at the Wilshire Plaza Hotel. Other interesting meetings are Wesco's (Warren Buffet's partner, Charlie Munger, is CEO) at 2:00 p.m. on May 9 at the Pasadena Center. Fremont General will be at 2:30 p.m. on May 17 at the Lowe's in Santa Monica.

Berkshire Hathaway's annual meeting is on May 5 in Omaha. One must at least own one share of stock to be in attendance. This is the largest shareholders' meeting in the country and has a carnival type atmosphere.

On April 24 at 5:30 p.m., I will be moderating a panel on the subject of activist investing for the CFA Society of Los Angles.

Experience for Holmes Osborne, CFA

Holmes Osborne began his career as a financial consultant for Merrill Lynch Private Client Group in Naples, Florida. At Merrill Lynch Mr. Osborne assisted clients in asset management and estate planning. After Naples, Mr. Osborne managed trust portfolios for Merrill Lynch Trust Company (a division of Merrill Lynch's mutual fund division) in Boca Raton, Florida. The trust department managed over $1 billion in clients' assets. Upon leaving Florida, Mr. Osborne worked in management for Farmers Insurance Group in Los Angeles, California.

Mr. Osborne has a degree in finance from the Martin J. Whitman School of Management at Syracuse University. Member of the CFA Society and holder of the Chartered Financial Analyst designation. Mr. Osborne is also a member of the National Association of Business Economists, Los Angeles Venture Capital Association, and Malibu Rotary.

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Clients' assets are held in custody at Fidelity Investments. At Fidelity, clients may have online access and will receive monthly statements.

All clients' information is kept in the strictest confidence. Mr. Osborne can be reached at 310-452-0910.

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