January 7, 2011

Dear Client,

With the completion of 2010, I celebrate the 20th anniversary of the founding of New West Investment Management, Inc. What started out as an attempt to better align the incentives and increase accountability in regards to investment portfolio management, while providing personal attention to client's planning needs and concerns, has turned out to be a rousing success. At year-end New West Investment handled portfolios totaling almost $30 million and as important, has over 50 long standing client relationships.

In addition, investment performance has been competitive with market averages over the longer term while subjecting clients to significantly less risk and volatility. This was accomplished by zeroing in on client needs and building balanced portfolios that focused on attractive opportunities while avoiding the latest investment craze. The ultimate measure of success is very low client turnover. The vast majority of individuals that have chosen to work with New West Investment are still with me and many have referred others to New West.

While this track record is something to be proud of, every day I strive to do better for my clients. A look back at all of the areas of the investment process that I have intensively studied covers broad macro economics, asset allocation, risk reduction and academic portfolio management techniques. I have also gained knowledge on government and market operations, politics and international relations. There has been attention paid to monetary systems, regulatory structures and the rule of law. I have digested untold volumes on individual security analysis and selection, and understanding financial products. And most recently I have spent time on behavioral economics, which is basically the study of how human emotion and logic interact in the decision making process.

I started in the investment business as broker, now called a financial advisor, with the firm of E.F. Hutton & Company in 1984 selling suitable products to clients for commissions. It was a great way to learn how Wall Street works, and the lessons learned have been invaluable in allowing me to help my clients avoid nasty surprises. The large financial firms still work pretty much the same way, which is why in 1990 I left to start New West Investment Management, Inc., a registered investment advisory firm. The main differences are I am bound to act as a fiduciary, meaning I have to put my client's interests before my own, and provide full disclosure of any conflicts of interest I may have or any compensation I might receive. I also report on investment performance in great detail on a quarterly basis, which introduces a high degree of accountability. And of course, I am paid a fee for my work based on account values which creates a partnership arrangement with my clients. All in all, a great improvement for all involved.

I have carefully reviewed why the couple of clients a year that have left New West Investment choose to do so. A few spent the portfolio down, fully half have passed away, a couple lost confidence in the stock market, two others were lured to high fee variable annuities and the promise of some guarantee, four or five wanted to transfer investment authority to a close relative that had an interest in investing and the final four or five wanted a more aggressive investment approach than I was willing to pursue. Each departure was a disappointment to me but provided motivation to work harder on investment performance and communications with clients to address their needs and concerns. I have been blessed with the remaining clients being very patient and understanding regarding volatility, uncertainty and the time lag between when market imbalances are identified and when they have a positive or negative effect on portfolios.

This last point was hammered home in reading The Big Short, a book about the collapse of the mortgage market and the few hedge fund investors that profited from the failure. Each of these individuals perfectly identified the top of the real estate market, understood that this would trigger a credit crisis, positioned their portfolios to benefit from the decline, and stuck with the trade to maximize profits for their clients. What is notable is that the top of the

market occurred at the end of 2005 and the profit for clients did not develop until the last quarter of 2008. During that period each portfolio manager suffered doubt, ridicule and in some cases litigation from impatient fund investors. The latency between the development of excesses in the markets and the actual associated price movements can be tough on money managers. Fortunately, I have had very little external pressure and suffer more from concerns regarding delivering excellent results for my clients.

No walk down memory lane would be complete without touching on some of the extremes I have witnessed in my time in the professional investment world. My earliest recollections are of the run up of both interest rates and the stock market in early 1987, only to be followed by Black Monday, which saw the Dow Jones Industrial Average decline by 22% in one day. Newly installed Federal Reserve Chairman Alan Greenspan flooded the market with liquidity in order to save the economy and because it worked so well, he became a one trick pony. His solution to any economic trouble was to pour on the cheap money.

In 1989 and '90 the Savings and Loan crisis and the first Gulf War, and the associated spike in oil prices gave me my first chance to witness the effects of stupid lending by financial institutions, leading to subsequent numerous failures, and government involvement in working off the excesses. It also was my first experience with the effects of war on the financial markets. In the recovery period, Chairman Greenspan's low interest rate policy harmed savers and investors that did not have balanced portfolios, another lesson learned.

The unprecedented four year run in the stock market to end the '90's, interrupted by severe declines tied to the Asian contagion debt defaults and the failure of Long Term Capital Management, provided a warning about the frailties of investment markets. The decade ended with the culmination of the Large Capitalization stock, Technology and Telecommunications bubble, fueled by liquidity pumped into the economy to offset the Long Term Capital failure and in anticipation of Y2K. It was a front row seat to the misallocation of capital that occurs when there is excess liquidity in the financial system. The market crash that followed served as an eye opener to the risks of jumping on the band wagon, a fate I managed to avoid to my great dismay in 1999 and to my enormous joy in 2000. The beginning of the new millennium provided yearly panics, the Tech & Telecomm crash in '00, September 11th in '01, the Accounting Fraud in '02 and the second Gulf War in '03.

In order to combat all these problems the Federal Reserve again got on its only pony and kept interest rates too low for too long and ignited the real estate, lending and commodity bubbles that has damaged the net worth of many market participants in a way that was more detrimental than had the Fed just let economics run its course. Unfortunately, that leaves us with the current flooding of the system with money by the new Fed leader Ben Bernanke, which while it helped the stock market recover, has deprived investors of any return on savings and safe investments while firing up speculation in the riskiest assets classes and commodities. It has also created a mess of government involvement in the economy and led to outrageous budget deficits. It's a hell of a way to run a country.

In reviewing the investment performance of my accounts over the last year it is important to recognize that I have always taken a Hippocratic Oath approach to asset management; first do no harm. In fact, at the end of August my average account was outperforming all of the stock market indices, down fractionally on the year. And it was at that point that I made an excellent call, that the market was due for a leg up through year-end and into 2011. Unfortunately, at the same time Fed Chairman Ben Bernanke decided the markets needed another dose of liquidity and I got left behind as often happens in a straight up market run. Considering the accounts I manage that are over $100,000 in size, before fees but after commissions, for the year 2010, all beat the return provided by money market funds and marginally outperformed intermediate term U.S. Government bonds, the vast majority did better than the EAFE International stock index, but all of my account badly trailed the Russell Top 200, Mid-Cap and 2000 indices as well as the performance generated by the 30 year U.S. Government bond. I did not have enough exposure to the stock market to keep up, and the exposure I did have was not in the hot areas.

Of course, portfolio management is not a sprint but a marathon. On a three year basis that includes a pretty nasty bear market, all of these accounts performed better than the Russell Top 200 and EAFE International stock indices, a majority did better than money market funds and the Russell Mid-Cap stock index while some of my accounts underperformed the Russell 2000 small cap index by a little and most did less well than the 30 year U.S. Government bond in the period.

Looking forward, it is a challenging time to be a balanced portfolio investment manager as the return that can be expected from bond holdings in no way justifies the risks of holding these investments. As such, I am allowing that portion of my portfolios exposed to bonds to run off as the bonds come due and do not anticipate any new commitments in that area except as a parking place for funds short term. There are also a number of macro economic imbalances that preclude me from being fully invested in stocks, which is a highly unlikely event for my portfolios in any case. That said, I am somewhat optimistic about the U.S. stock market in general for the next year and feel comfortable with the stock holdings I have in place at this time. I am also finding some attractive new stock investment ideas from time to time. The following is a list of some of the “this can’t go on forever” concerns I have regarding global economic imbalances.

According to a Chinese economist, China has over 64 million vacant housing units, 1.5 times the number adjusted for population size that has caused the U.S. such problems over the last couple of years. This continuing construction of excess structures on mainland China has put significant strains on global building commodity supplies and forced up prices on those same commodities. It has also created the same false appearance of economic strength that occurred in the U.S. and led to a significant disruption in our economy when the truth was discovered.

In Japan, it is reported that the Government already pays out more in debt service and social security payments than it take in from tax revenue, requiring continued borrowing for other expenditures. This is possible due to investment in Japanese Government bonds by its citizens. But as the population ages, the total population declines, the economy fails to grow and the debt burden continues to expand, there will come a day of reckoning.

In Europe, there are a number of countries that have encumbered themselves with so much debt that it will be impossible to pay it off in full. If each country had a freely trade currency, that would allow for currency weakness to offset some of the debt. However, the Euro does not allow for currency adjustments, so it is very likely that eventually there will be defaults on Government issued securities. The problems are magnified by the debt being largely held by European banks that cannot afford to take the loss without becoming insolvent.

And finally, while the U.S. is showing signs of a slow but steady economic recovery, longer term we also suffer from some unsustainable imbalances. Starting at the top, the Federal Government is spending a third more than it is taking in from tax revenues and will have to restructure entitlement programs, think social security and Medicare/Medicaid, to bring spending under control. State and local governments are also out of whack due to recent years of overly generous retirement benefits to union employees coupled with weak property tax receipts because of the recession. There are still issues regarding excessive consumer debt, high unemployment and the possibility of further real estate price declines and the loan default problems that these engender.

This is by no means a comprehensive list, but provides plenty of reasons for caution. All of these situations are unsustainable in the long run, however it is impossible to know if these problems will escalate or be address before they become globally disruptive. Enclosed please find your yearend portfolio report that shows account performance over the last three years, if I managed it for that time frame, and since inception. Also included are details about realized gains or losses for your taxable accounts and a list of management fees paid to New West during 2010. I am mailing this report so you will have it as quickly as possible. I will follow up as time permits, or feel free to call if you have questions, comments or concerns. I appreciate your faith in my handling of your investments.

Best regards,

Peter V. Hedberg