



Baltimore Capital Management

575 S Charles Street, STE 506

Baltimore, MD 21201

Phone: 410-727-4480

Fax: 410-783-7917

E-mail: agraham@baltimorecapital.com

www.baltimorecapital.com

October 2, 2007

SAMPLE

Dear client

Year to date your account has had a gain of xxx. This compares to the S&P 500 gain of 9%.

We are not pleased with our investment performance thus far this year. It has been affected by some investment decisions related to the housing market, but also a poor market call. Let me explain.

For starters, we have owned Countrywide Credit, probably one of the most controversial and poorly performing stock one could have owned this year. Countrywide is not a new name to us. I first heard of this mortgage bank about 20 years ago, when I used it to obtain a mortgage on my home. I was surprised by the efficiency and ease of the process with Countrywide, compared to the hassle of obtaining a bank mortgage in those days. I decided then to buy the stock, the value of which has increased almost ten-fold over the years. Countrywide has always been a rather volatile stock, and when it has dipped I have purchased more for my accounts. Earlier in 2007, when the stock was at its year highs on a takeover rumor, I did sell some of it in accounts that owned too much.

As you might have heard through the media, during the current credit crunch it has become difficult for Countrywide and similar companies to obtain the financing that is essential for their business. Over the past few months many of Countrywide's competitors have been forced to file for bankruptcy. Countrywide has the advantage of owning a bank subsidiary that can borrow from the Federal Reserve System.

Obviously we are not pleased with the stock's current performance, but it has become clear that Countrywide, which issues about one in six mortgages in the United States, is too big to fail. In fact, our research indicates that the company not only will survive, but in the future it probably will benefit by having fewer competitors. Consequently, we decided that the upside on Countrywide far exceeded the downside. While it may have been easier to sell the stock at its lows and put it behind us, we believe that the better investment decision is to wait it out. Selling a stock at its year lows and maximum point of unpopularity is seldom the right choice. Nevertheless, our decision to retain this stock has obviously had a negative effect on our year-to-date performance.

Another decision affecting our performance to date is our continued ownership of DR Horton, one of the country's largest homebuilders. Clearly the housing business is awful at the moment, and as a result DR Horton and all the homebuilding stocks are very much out of favor. While we might have underestimated how long the housing slump would last or how low we thought these stocks would go, we are confident that the construction of homes in the US will recover. Again, while we are not pleased with current performance, this is the wrong moment to sell DR Horton. In fact, if we did not already own such stock we would be shopping in the sector for investments given the currently favorable prices.

We have taken a close look at our exposure to housing stocks in all our accounts, and find that it is not unusually or unreasonably high. With time, we believe that these stocks will be big winners, perhaps not this year but very likely next year. Even if the housing market does not recover in 2008, anticipation of a recovery during the year will likely push the valuation of these stocks sharply higher.

As for the market call, we started the year in a bearish mood and bought a security (Ultrashort Pro Shares) that would benefit our accounts if the market dropped. It did drop, but unfortunately not before first moving up. Our timing, which was too early, made this investment a loser.

Not all hope is lost! Most mutual funds have a September fiscal year and take their tax losses in that month. This usually puts extra pressure on stocks that are out of favor at the time. As we enter the fourth quarter, these stocks tend to move up. Additionally, during the just-ended third quarter we have had a market correction of 10%, which was sorely needed and a healthy sign. The market correction has made financial stocks more attractive than most. We have been able to buy regional banks and insurance companies at valuations not seen in ten years. When one can find stocks trading at 1 to 1.5 times book value, with low PE ratios and high dividend yields, it is worth making purchases. The companies we invested in were not only at their year lows, but have no exposure to the sub-prime market and its loan defaults. We also used the market decline to reduce our cash position by buying high quality names when they were trading down. As I've noted in previous communications, we believe that times like these should be viewed as buying opportunities.

In summary, we are more bullish than we have been in the past year, and view the volatile market as an opportunity, not something to fear. Our accounts have traditionally done well in the fourth quarter. We hope we will see a repeat this year.

We thank you for your patience, and remain convinced that with time our holdings will do well. We are making every effort to monitor each holding and to focus on what will make money over the next year.

Should you have any questions please do not hesitate to call us or email me at agraham@baltimorecapital.com

Sincerely,

Alec Graham

Baltimore Capital MGT
575 S Charles ST, STE 506
Baltimore, MD 21201

Phone: 410-727-4480
Fax: 410-783-7917
agraham@baltimorecapital.com
www.baltimorecapital.com

Upon written request, we will deliver a copy of our Part II of the form ADV and a balance sheet.