October 31, 2011

"Ben, the two of us need look no more
We both found what we were looking for
With a friend to call my own
I'll never be alone"
- Michael Jackson, Ben

"Good things happen to cheap stocks."
- Steven Romick, manager of the FPA Crescent Fund

Dear Client,

While we outperformed the market by almost 300bps in the third quarter, September was a far more brutal month than we would have expected given the concentration of high quality businesses that make up the bulk of our portfolio and the large cash position we have held.

Correlation and volatility remain extraordinarily high. Cryptic statements from Ben Bernanke (and the even more obtuse European leadership consortium) carry far more weight than underlying company fundamentals in today's "risk on, risk off" trading environment.

When the noise becomes loudest, we find it most useful to get back to basics. We'll spend a portion of this effort discussing the current market environment, but the bulk is dedicated to a fundamental discussion of our four largest equity positions which make up approximately 23% of our equity separate accounts. But first, our typical performance table as of September 30, 2011[1]:

	Q3	YTD	TTM	Cumulative Since 10/06
Grey Owl Opportunity Strategy (net fees)	**-10.88%**	**-7.66%**	**-2.85%**	**15.01%**
Spider Trust S&P 500 (SPY)	-13.82%	-8.72%	1.11%	-8.87%
iShares MSCI World (ACWI and MXWD)	-18.92%	-15.42%	-7.49%	-9.85%

[1] For more information regarding performance, please refer to the performance disclosure at the end of this letter.

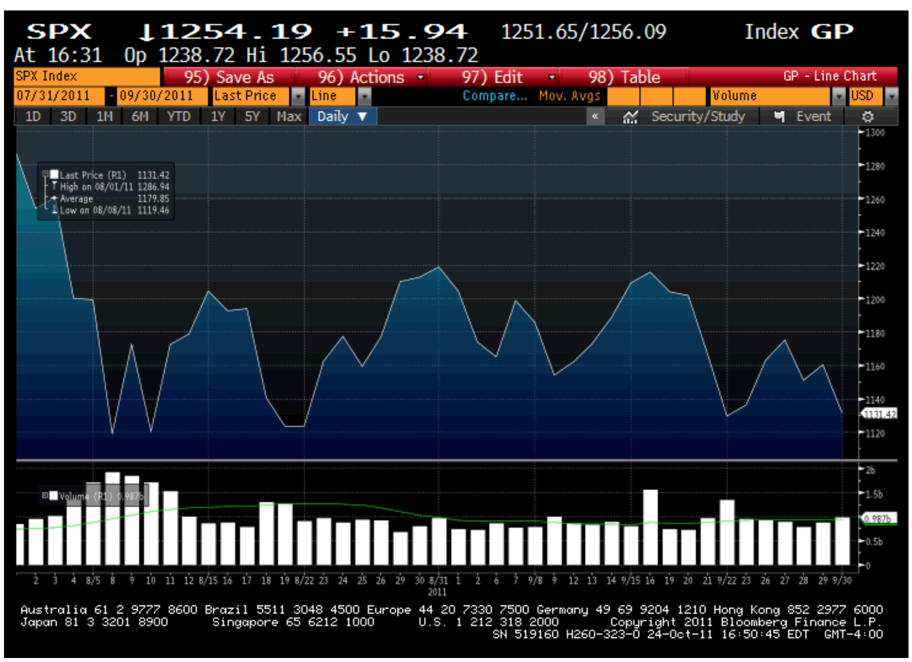
Bizzaro World

It seems like we've been transplanted to the fictional planet in the *DC Comics* universe where everything is inverted. How else do you explain the behavior of assets subsequent to Standard and Poor's downgrading US Treasury debt on August 5th? Here is a comparison of select asset class returns from that date through the end of the quarter:

30 year US Treasury Zero Coupon Bond	35.23%
S&P 500 Index (total return)	-5.36%
Russell 2000 Index (total return)	-11.11%
Barclays Aggregate Bond Index ETF (AGG)	0.98%
Gold ETF (GLD)	-1.60%

Despite the headline downgrade of US debt, in a fear-driven market, investors are conditioned to seek safety in what has been, since World War II, the world's reserve currency. It will likely take years for this muscle memory to atrophy. With the US debt ceiling drama giving way to sovereign financial concerns in Europe, the fear gauge was high.

The uncertainty was equally manifest in equity markets. The S&P 500 traded half a dozen eight percent swings in just August and September. Real issues of slow economic growth, expensive markets, and unserviceable debt caused investors to sell. Then "our friend Ben" (or his European counterparts) responded with a "twist" or "QE" or the concept of a "stability" package and traders were off to the races: RISK ON! (As if money printing could create wealth.)



The correlation data further demonstrates that macro events, not business fundamentals drive day-to-day price movements in today's markets. Eighty percent of stocks have traded in directional sync for the last two months.

Unfortunately, until such time as global, developed world debt levels become sustainable and constant fiscal and monetary tinkering abates, we expect volatility and correlation to remain high. We don't pretend to have an edge in anticipating these actions. Where we do have an edge is in our ability to make "time arbitrage" investments. Companies that trade at low valuations and that can consistently grow intrinsic value provide very strong returns over multi-year periods. This is the core of our portfolio and where we turn next.

Review of Four Largest Positions: 23% of Portfolio Assets[2]

We run a concentrated portfolio. As of September 30, 2011, our top four positions made up almost 23% of total assets. Typically, our top positions are "core holdings" that we would expect to own for many years. While it would sure make life easier if the market values of our securities positions increased at a steady rate, that will never be reality. Security returns will be lumpy, even in high-quality businesses. Thus, we tend to spend more time worrying about the underlying business dynamics than day-to-day, week-to-week, or quarter-to-quarter

[2] As of September 30, 2011.

investment returns. For each of our top four holdings, the underlying business dynamics remain quite strong and improving while the stock prices remain cheap.

Microsoft

Position size on 9/30: 7.3%

We have discussed Microsoft at length, most recently in a blog post and prior to that in our third quarter 2010 letter. While the market price for Microsoft stock has barely budged in the last year[3], its business fundamentals have greatly improved. Annual earnings per share (EPS) are up 19% year over year, shares outstanding have shrunk, and the dividend was increased 25%. The company continues to make gains. We own Microsoft at a current P/E excluding net cash of 7 and a dividend yield of 3%. This price projects a massive deterioration in Microsoft's business going forward. Based on all the available evidence, nothing is further from the case. Good things happen to cheap stocks.

Key Statistics

Fiscal Year[4]	**Q1 2012**	**Q1 2011**	**Q1 2010**
Revenue	$17.5B	$16.2B	$12.9B
revenue growth yoy	*7.27%*	*25.35%*	*-14.22%*
EPS (Q)	$0.68	$0.62	$0.40
EPS growth yoy	*9.68%*	*55%*	*-16.67%*
EPS (TTM)	$2.75	$2.32	$1.54
EPS growth yoy	*18.53%*	*50.65%*	*-19.37*
Free Cash Flow	$8.1B	$7.6B	$5.7B
Net Cash	$45.5B	$33.5B	$30.7B
Dividend	$0.20	$0.16	$0.13
Shares Outstanding	8,410mm	8,562mm	8,900mm
share growth yoy	*-1.78%*	*-3.95%*	*-3.08%*
Stock Price	$24.89	$24.49	$25.72
P/E (TTM)	9.05	10.56	16.70
P/E ex net cash (TTM)	7.08	8.87	14.46

Berkshire Hathaway

Position size on 9/30: 5.7%

Over the past three years, Berkshire Hathaway has been able to compound per share book value at an average rate of 9.4% per year. This includes the bottom of the recent recession and

[3] MSFT's stock price was $24.89 on 9/30/2011 vs. $24.49 on 9/30/2010. Including dividends, this was a total return of 4.2% compared to a total return on SPY (the S&P 500 index ETF) of 1.11% over the same time period.

[4] MSFT's fiscal year ends June 30th. Thus, the Q1 2012 fiscal quarter is the calendar quarter ended 9/30/2011.

related stock market selloff. (Berkshire's very large equity portfolio is a significant percentage of book value and is marked to market.) In addition, free cash flow from Berkshire's operating businesses has grown out of the recessionary trough at an extraordinary rate. We expect Berkshire should be able to grow book at a low double-digit rate for several years. Given this, we think the stock should trade at between 1.5 and 1.75x book. Today it trades at 1.15x book. Good things happen to cheap stocks.

Key Statistics

Calendar Year	**Q2 2011**	**Q2 2010**	**Q2 2009**
Revenue	$38.3B	$31.7B	$29.6B
revenue growth yoy	*20.70%*	*7.10%*	*-1.61%*
Free Cash Flow	$4.5B	$2.0B	$1.6B
fcf growth yoy	*125%*	*25%*	*1000%*
Shareholder's Equity	$166.8B	$147.5B	$118.8B
Shares Outstanding	1.65mm	1.65mm	1.55mm
Book Value per Share	$101,091	$89,393	$76,645
bv/s growth yoy	13.09%	16.63%	-2.78%
Stock Price	$116,105	$120,000	$90,000
P/B	1.15	1.34	1.17

Lexmark

Position size on 9/30: 5.3%

We discussed our Lexmark investment thesis at length in our last quarterly letter. Lexmark is transitioning out of its consumer printing business to focus exclusively on business printing. We want to see their "core" business printing segment grow as a percentage of revenue quarter by quarter and year over year. This is happening. We also want to see the operating margin continue to expand, as this higher margin business becomes a greater percentage of revenue. This too is happening. Thus, while Lexmark's revenue growth is anemic, its EPS growth is quite reasonable. Once the consumer business is fully exited, modest top line growth should resume. Frankly, trading at 4.61x EPS (excluding net cash) Lexmark is priced like a wasting asset: a royalty trust with a six year life and a flat payout structure would provide an 8% annualized return if you paid 4.6x its payout. Given a reasonable expectation of mid-single digit earnings growth, a high return business like Lexmark[5] should trade at a mid-teens multiple. Good things happen to cheap stocks.

[5] Lexmark's return on equity was 22% for the trailing twelve month period ending 9/30/2011.

Key Statistics

Calendar Year	Q3 2011	Q3 2010	Q3 2009
Revenue	$1035mm	$1020mm	$958mm
revenue growth yoy	*1.47%*	*6.47%*	*-15.27%*
Core % of Revenue	83%	76%	73%[6]
Growth in Core Business YoY	10%	nm	nm
Operating Margin	9.6%	9.1%	2.5%
Net Cash	$572mm	$470mm	$360mm
EPS (TTM)	$4.27	$3.93	$1.33
EPS growth yoy	*8.65%*	*195.49%*	*-61.11%*
Shares Outstanding	78mm	79.7mm	78.6mm
share growth yoy	*-2.13%*	*1.40%*	*-9.76%*
Stock Price	$27.03	$44.62	$21.54
P/E	6.33	11.35	16.20
P/E ex net cash	4.61	9.85	12.75

Markel

Position size on 9/30: 4.9%

Over the past three years, Markel has been able to grow book value per share at an average rate of 12.26%. This includes the recession and market trough and like Berkshire, equity securities make up a meaningful portion of Markel's book value. Markel is far smaller than Berkshire. Whereas Berkshire has in many ways become a broad industrial company, Markel is still almost purely an insurance operation and has thus suffered more directly in the current soft insurance market. We expect Markel will be able to grow its book value in the low double digits for many years and could experience significant book value growth when insurance markets harden. Therefore, we think the stock should trade between 1.6 and 1.9x book. Today, Markel trades, like Berkshire, at just 1.15x book. Good things happen to cheap stocks.

Key Statistics

Calendar Year	Q2 2011	Q2 2010	Q2 2009
Shareholder Equity	$3.35B	$2.87B	$2.35B
Shares Outstanding	9.69mm	9.77mm	9.82mm
Book Value per Share	$345.72	$293.76	$239.31
bv/share growth yoy	*17.69%*	*23.01%*	*-5.53%*
Stock Price	$396.81	$340.00	$281.70
P/B	1.15	1.16	1.18

[6] Core percent of revenue is from 1Q10. This is the earliest quarter for which breakdown was made available.

Conclusion

Buckle your seat belts. We fully expect markets to remain manic and co-dependent. The market can't live without its friend Ben, so a few weeks of weak data and no intervention and we'll have a selloff. Likewise, as soon as rumors of the next hundred billion dollar intervention surface, traders won't be able to buy equities quickly enough. The situation in Europe is a mirror image. Thankfully, in a world of 20,000+ individual securities there are always pockets of opportunity. We must be prepared for our individual ideas to trade with the market for periods of time, but over the long-haul "good things happen to cheap stocks." When possible and prudent, we will use manic periods to lighten our exposure and depressed periods to add to our best ideas. In addition, we are working hard to mute volatility if we can do so without sacrificing long-term results.

As always, if you have any thoughts regarding the above ideas or your specific portfolio that you would like to discuss, please feel free to call us at 1-888-GREY-OWL.

Sincerely,

Grey Owl Capital Management

Grey Owl Capital Management, LLC

This newsletter contains general information that is not suitable for everyone. The information contained herein should not be construed as personalized investment advice. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in the stock market involves the potential for gains and the risk of losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security. Any information prepared by any unaffiliated third party, whether linked to this newsletter or incorporated herein, is included for informational purposes only, and no representation is made as to the accuracy, timeliness, suitability, completeness, or relevance of that information.

The securities discussed above were holdings during the quarter ended September 30, 2011. The stocks we elect to highlight each quarter will not always be the highest performing stocks in the portfolio, but rather will have had some reported news or event of significance or are either new purchases or significant holdings (relative to position size) for which we choose to discuss our investment tactics. They do not necessarily represent all of the securities purchased, sold or recommended by the adviser, and the reader should not assume that investments in the securities identified and discussed were or will be profitable. A complete list of recommendations by Grey Owl Capital Management, LLC may be obtained by contacting the adviser at 1-888-473-9695.

Grey Owl Capital Management, LLC ("Grey Owl") is an SEC registered investment adviser with its principal place of business in the Commonwealth of Virginia. Grey Owl and its representatives are in compliance with the current notice filing requirements imposed upon registered investment advisers by those states in which Grey Owl maintains clients. Grey Owl may only transact business in those states in which it is notice filed, or qualifies for an exemption or exclusion from notice filing requirements. This newsletter is limited to the dissemination of general information pertaining to its investment advisory services. Any subsequent, direct communication by Grey Owl with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of Grey Owl, please contact Grey Owl or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov).

For additional information about Grey Owl, including fees and services, send for our disclosure statement as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest or send money.

The performance information for the Grey Owl Opportunity Strategy presented in the table above is reflective of one account invested in our model and is not representative of all clients. While clients were invested in the same securities, this chart does not reflect a composite return. The returns presented are net of all adviser fees and include the reinvestment of dividends and income. Clients may also incur other transactions costs such as brokerage commissions, custodial costs, and other expenses. The net compounded impact of the deduction of such fees over time will be affected by the amount of the fees, the time period, and the investment performance. Grey Owl Capital Management registered as an investment adviser in May 2009. The performance results shown prior to May 2009 represent performance results of the account as managed by current Grey Owl investment adviser representatives during their employment with a prior firm. THE DATA SHOWN REPRESENTS PAST PERFORMANCE AND IS NO GUARANTEE OF FUTURE RESULTS. NO CURRENT OR PROSPECTIVE CLIENT SHOULD ASSUME THAT FUTURE PERFORMANCE RESULTS WILL BE PROFITABLE OR EQUAL THE PERFORMANCE PRESENTED HEREIN. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. For additional performance data, please visit our website at www.greyowlcapital.com.

The indices used are for comparing performance of the Grey Owl Opportunity Strategy ("Strategy") on a relative basis. Reference to the indices is provided for your information only. There are significant differences between the indices and the Strategy, which does not invest in all or necessarily any of the securities that comprise the indices. In addition, the Strategy may have different and higher levels of risk. Reference to the indices does not imply that the Strategy will achieve returns or other results similar to the indices. The performance shown for the iShares MSCI World Index Fund ("Fund") includes performance of the MSCI World Index prior to March 26, 2008, inception date of the Fund.