

FPA Crescent Portfolio

July 23, 2001

Dear Fellow Shareholders:

We have completed the first half of 2001, increasing the Crescent Portfolio's value 15.04% for the quarter and 24.46% for the year to date. The market index returns year to date fall in the range of +6.85% (Russell 2000) to -12.52% (Nasdaq). The rotation from growth to value continued in the second quarter and put the wind at our backs. The companies we own have, on average, performed well but not well enough to justify such a large gain in Crescent. The valuations of the companies we own have rebounded from distressed and irrational levels and, yet, still trade at lower P/Es than the market indexes.

We might not give you an entertaining high-wire act, but we do not want our investments to be breathtaking anyway. We want to make sure that we will always have capital to invest and, like the fabled tortoise, make our way to the finish line. What awaits us there is nothing more complex than survival. If you retain your capital, you will always be able to invest. Said another way and reflecting the visceral bombarding of too many television commercials, we do not want to get voted off the island.

Two companies we own have been bought out this year. In the first quarter, UPS purchased Fritz Companies and in the second quarter Cendant announced the purchase of Galileo. Both of these companies contributed positively to our return but, more interestingly, were sold for prices that were more than 2x where they had been trading in the prior 12-month period. Such discounts to private market value would not exist if the stock market was truly a rational place, as Burton Malkiel espouses in his *Random Walk Down Wall Street*.

You will be happy to know that, although dot.com companies have seen billions of dollars of value evaporate, you could still have a dot.com to guide your investing strategy. If you visit galacticinvestor.com, you will learn to use planetary cycles to enhance your portfolio's returns. Many investing theories abound – some rational, others less so. The irrational, emotional, uninformed investor allows us to find our investment opportunities. Crescent's strong relative returns over the past year and a quarter have not resulted from a change in strategy. We remained committed to value investing throughout the spectacular growth stock market of the late 1990s despite underperforming. Recently our value philosophy has been paying dividends. Many of the companies we own have seen their stock prices increase for the same reasons that they declined – none. IHOP, for example, has increased earnings at a 18%, 15%, and 21% rate over the last 3, 5 and 10 years, respectively, without growing its earnings less than 9% in any one of those years. IHOP has seen its stock price fall from \$26 in 1999 to \$14 in 2000 only to see it rebound to \$27 at June 30, 2001. Its stock price was not expensive in 1999, trading at 16.5x 1999 earnings per share (EPS), and after declining almost 50%, it was ridiculously cheap at 8x 2000 EPS. Today, IHOP's stock trades at 15.3x trailing and just 14.1x projected 2001 consensus EPS – still far cheaper than the stock-market averages with what we believe to be better growth prospects. IHOP serves as a good example that stock prices do not necessarily reflect the intrinsic value of a business. If they did, they would not reflect such price volatility.

Many people think investing in the stock market is gambling. The stock market's volatility magnifies this casino mentality. If you do not understand the business you own, its growth prospects and how it turns sales into cash, and how much you are paying for your interest, those individuals are certainly correct. Even if you have done that work, you still need to judge the odds of success. Nobody has a perfect track record in investing. We all have made mistakes and, hopefully, learned from them. Therefore, one must consider the odds. Some people go to the horse track and bet the long shot at 100 to 1 odds, where their chances of losing are extremely high. Others find solace in betting the favorite at 3 to 2 odds where their chances of winning are high but they do not get paid much if they win and are still risking 100% of their investment. We prefer to find those horses where the odds have been miscalculated. Where we have the probability of winning a lot and, if we are wrong, do not make very much or lose very little. The path to investing success is good research – to know your prospective investment's odds of success better than the “market” that places incorrect odds. We call this our pari-mutuel path to success.

Much has been made of recent economic weakness. Whether or not the U.S. economy is in recession is not yet clear, but what is obvious is that our economy, at minimum, has experienced massive deceleration. The economy continues to appear sluggish at best despite the most aggressive Fed action we have ever seen. The stock market has continued to decline given a weak economy combined with what continues to be relatively high valuation levels for public businesses. We believe that Wall Street's earnings estimates for this year and next remain too high.

The consumer continues to spend despite an increase in job layoffs and losses taken in the stock market, displaying greater strength than we imagined possible in this slowing economy. The reason for this might be that the consumer has had the cushion of rising equity in their home even with an increase in their home equity loans, according to Alan Greenspan in this week's congressional testimony. We believe that as the consumer behaves, so goes the economy. For example, if more job layoffs, further declines in the stock market, a decline in home values, etc., shake the consumer, then the economy is in for rough sledding. If the consumer remains resilient, then we would expect an economic rebound in the first half of 2002. Many expect a V-shaped recovery beginning in the second half of this year. We expect the recovery will begin a quarter or two later than the consensus and that it will be U-shaped with more time spent bumping along the bottom. The vast amounts of capacity that have been added in the technology and telecommunications sectors will continue to put a lid on economic growth for the foreseeable future. We have exhausted our prognostic abilities with this economic forecast. We do know that at some point in time the economy will improve. Stock prices generally advance in anticipation of an improvement in the economy so it does not pay to wait until that time to invest in the stock market. Meanwhile, we will continue to search for companies and industries that have good growth prospects but are currently out of favor.

Despite Crescent's advance and the stock indexes declines in the first half, Crescent continues to have a lower valuation than the comparative stock indexes below. Crescent's price/earnings ratio has increased dramatically from the first quarter due to appreciation of securities held as well as certain investments that have been made in businesses that are currently earning far less than they would in a more “normal” environment. We make a practice of seeking businesses whose earnings are temporarily depressed because of economic weakness, industry weakness, or management missteps. Our price/book ratio remains relatively low, supporting our value approach.

Ratios (Weighted Average)	Crescent	Russell 2500	S&P 500	Lehman Bros. Gov't/Credit
<i>Stocks</i>				
Price/Earnings TTM	17.9x	27.8x	26.4x	
Price/Earnings 2001 est.	17.9x	25.4x	24.8x	
Price/Book	1.4x	2.4x	3.9x	
Dividend Yield	1.3%	1.3%	1.3%	
<i>Bonds</i>				
Duration	3.3 years			5.5 years
Maturity	7.0 years			9.5 years
Yield	12.3%			5.8%

Our ten largest equity positions represented 28.3% of the portfolio as of June 30, 2001. Listed below are Crescent's ten largest holdings, excluding short-term investments, as of that date.

Common & Preferred Stocks

Celanese
 Michaels Stores
 Ross Stores
 Ventas
 Crown American Realty Trust 11% Preferred
 Big Lots
 Pittston Brinks Group
 Arrow Electronics

Bonds & Notes

Charming Shoppes 7.5% Convertible Notes, due 7/15/06
 Harnischfeger Industries 7.25% Senior Notes, due 12/09/25

Crescent had the following net asset composition at June 30, 2001.

Common Stocks, Long	43.00%
Preferred Stocks	2.77%
Bonds & Notes	24.42%
Accrued Income	0.41%
Common Stocks, short	-5.50%
Cash & Other	34.90%
Total	100.00%

We believe that we have outperformed the market since its peak in March 2000 for a number of reasons. We have stayed with our value discipline where others have strayed. Things go in and out of fashion. Stick around long enough and you will see the Nehru jacket back in vogue. Investing cycles occur with greater frequency, although during the unavoidable periods of poor relative performance investor's patience and conviction will be tested. We believe our deep research capabilities give us a competitive advantage providing us with not just index beating returns over time, but the confidence to maintain our investment philosophy. Broadening our team with the addition of Dennis Bryan and Rikard Ekstrand has also benefited your portfolio's returns.

We have learned a number of investing lessons in our careers, even more during the recent few years. Some of those lessons have also contributed to our strong returns. In the past we focused on inexpensive companies, whereas today we place equal emphasis on those companies' ability to grow. When I asked a CEO whose company's stock price was languishing why he does not repurchase stock instead of add new stores, he replied that there is no such thing as standing still – either you are growing or shrinking. We have taken this to heart and have opted to shy away from those companies that are statistically cheap, e.g., low P/E, low Price/Book etc., but have little in the way of growth. Experience has also shown us that reaching for the marginal investment idea is usually not a good idea. If cash builds in Crescent, it will not be due to a macro market call but because we are not able to find companies that meet our investment criteria. We would rather see the cash collect an anemic money market rate of return for a period of time than to see it wither in a marginal investment that provides little in a way of return or worse, loses money and takes up valuable time that could be spent in researching more promising investments. We will continue to invest in the fashion to which we (and many of you) have become accustomed and we will hopefully do so in a continually improving fashion as we take to heart and practice the many lessons the stock market has to teach.

We would like to leave you with this excerpt from Leucadia National Corporation's recent Annual Report. Mr. Ian Cumming and Mr. Joseph Steinberg, Chairman and President, respectively, have proven exceptional investors over the past few decades and their annual reports always prove useful and informative reading for us as their thought process in many ways mirrors our own. "Leucadia's management wakes up every morning with several hundred million dollars invested in risk free treasury bills. Think of us as groundhogs with a daily habit. We pop out of our holes each and every morning and look around the marketplace for investment opportunities. The first question we ask is, 'Do we see anything that can earn more than the risk free rate, adjusted for risk?' When the markets are as high as they have been in the last many years, we saw very little of interest and went back down our holes. In fact, we successfully offered most of our assets for sale to others at what we felt were irrationally exuberant prices.... Our job for the next few years is to buy recurring earnings and prepare those assets for the next frenzy. Patience is required for this process, but it is not complicated."

Respectfully,

A handwritten signature in black ink, appearing to read "Steven Romick". The signature is fluid and cursive, written in a professional style.

Steven Romick