

LETTER TO SHAREHOLDERS

Dear Shareholder:

Crescent's performance has been reasonably good, considering that we have been sitting with a low percentage invested in stocks, 44.3% as of quarter-end. We continue to maintain sizeable exposure to energy companies, with 13.8% of your portfolio invested in the sector. Stock index performance continues to diverge, with the distinguishing characteristic being the size of the company. The small-capitalization Russell 2000 Index trounced the large-capitalization S&P 500 Index in the first quarter. Final score: 13.94% vs. 4.21%.

The shares of oil service jack-up rig companies were among our better performing investments for the quarter. The worldwide effective rig utilization has now moved to the high 90% level. As a result, day rates have been increasing rapidly.¹ We always believed the earning power of these companies was substantial and now we're getting the proof. At current day rates, the jack-up rig operators are selling at single digit free cash flow multiples. As their existing lower-priced contracts roll off, earnings should increase substantially over the next two years. In addition, they have added new rigs to their fleets. ENSCO, for example, recently announced the construction of two new semi-submersible rigs that will be delivered within the next few years. Because of these rigs' low cost design and the strong reputation of ENSCO, they already have four-year contracts that pay back the entire rig construction cost. The free cash flows that should be generated from these two rigs alone when in operation may approach a dollar a share — substantial value. ENSCO has two more high specification jack-up rigs being delivered this year and next. In addition, ENSCO has room to add another two semi-submersibles in addition to the two already announced.

We are farmers. We plant seeds and hope to sit back and watch them grow. After a time, we hope to harvest the fruits of our labors. We plant these seeds at different points in times and, further, expect that some of our plantings will mature quickly while others may take years. Crescent currently maintains 33 common stock positions, of which all but 4 have been profitable investments. We share this not to trumpet our 88%

investment success, but to point to the foreshadowing of a less fruitful future. It has been harvesting time for us and we have been taking our profits. We prefer stocks we own that are less than full positions to decline, not for a form of monetary masochism but for the prospect of committing additional capital to a business we already understand. Meanwhile, we are always looking for the next seed to plant. That, however, continues to prove more challenging.

We continue to see evidence of market action that defies what one would logically expect to be to the benefit of long-term, tax-efficient investment returns. There are a tremendous number of traders in the market and we cannot understand how they work either to their own or their clients' benefit. The evidence presents itself in the trading of many securities, with such securities as E-Bay, Amazon, and Google as just a few of the examples. The entire market value of these companies was bought and sold during 2006's first quarter. For example, the average daily trading volume of Google in the first quarter was 13.2 million shares at an average price of \$390.29 for an average daily trading volume in dollars of \$5.15 billion. Google's quarter-end market capitalization was \$118.6 billion. In other words, 100% of the market value of Google traded in just 23 trading days of the quarter!² If we were to exclude the insider and the closely held institutional shares (just the shares available for trading, i.e., the float), the value of the entire company would have traded even more quickly. We believe such trading is speculative and tax inefficient and imparts a bitter flavor for some of what we are seeing today.

Dividends may seem boring when compared to the trading action offered by Google; however, dividends have always been an important part of stock-market returns. Over the past 75 years, dividends have accounted for about 40% of the total stock-market return.

75-year stock-market return	11.1%
75-year average dividends	4.4%
75-year capital appreciation	6.7%

If prospective capital appreciation were to be the same as it has been in the past, with the current S&P 500 dividend yield of 1.8%, stock-market returns

¹ Day rates are the daily rates that the oil companies pay the drilling companies for the use of their rigs.

² \$118.6 billion market capitalization / \$5.2 billion average daily trading volume.

would be 2.6% lower, or 8.5%.³ This assumes, of course, that capital appreciation will be the same in the future as it has been in the past — not something you should take for granted. For that to occur, corporate earnings need to increase at a rate equal to historic rates, or Price/Earnings ratios (P/Es) need to expand. No easy feat, especially if you consider that after-tax corporate profit margins now approach 9.5%, a post-World War II high. A 30% decline in profits would bring us back to average profit margins. We do not prognosticate such a decline, but depict it to reflect the challenge of achieving future margin expansion and with it, the earnings growth necessary to meet the consensus expectations of Wall Street. History is rife with examples of the perishable margin. Place this in context with valuation levels that remain slightly greater than the historic median and you can see why we have some issue with aggressively putting capital to work today.

We believe that dividends will have greater importance to future market returns and therefore advocate that companies increase their payout ratios. The current dividend payout ratio for the S&P 500 is approximately 30%, a historic low versus an average of 54% since 1930.⁴ The lower the ratio, the greater the amount of cash available for other corporate purposes such as capital spending or share repurchases. Capital spending has not been unusually robust but many companies have engaged in aggressive share-repurchase programs. Repurchasing shares can add to shareholder value, assuming that the shares have been bought at a price that allows the company a yield in excess of their cost of capital and that those shares bought do not merely offset dilution from stock options that have inequitably accrued to management's benefit. If companies paid dividends more akin to what they have done historically, then the current 1.8% dividend would be 3.2%.⁵ Many large companies have the ability to increase their dividends and should, as long as they do not have a higher return use for that capital. This is all the more important in the current tax environment, where the IRS taxes dividends at the same rate as capital gains.

We are at a disadvantage today. We are accustomed to buying on bad news and there just is not a lot of that going around. We continually seek the next distressed industry in which to commit capital. A number of us at FPA have been spending time on the auto industry. The auto industry is in good health, with the sale of cars approximating a 16 million annualized rate in the U.S. Cars are selling and not just those from Detroit. Honda, Nissan, and particularly Toyota are eating Motown's lunch — and breakfast and dinner too. Years of high labor costs, weak management, and little innovation now haunt the U.S. auto manufacturers and their suppliers. U.S. auto manufacturers' 96% market share in 1965 has eroded over time to 57% in 2005. Many suppliers have filed for bankruptcy, e.g., Dana Corp., Collins & Aikman, and Delphi. We expect more to come. These companies have fallen on hard times and the economy is still in good shape. In a recession, we would expect to see auto sales decline to less than 15 million units, and possibly lower. Meanwhile, restructurings will not happen overnight. Plants will be closed. Workers laid off. Creditors will fight over the carcasses. All this takes time. We expect to see more auto-supplier bankruptcies and a weak economy to make matters worse before the proverbial light is seen at the end of the tunnel. Nevertheless, given our long investment horizon, we expect to own common shares and debt of companies in this sector. In all likelihood, we will be early and, given that, we will be able to build our positions as prices decline.

We strive to price risk appropriately. That is, we expect a prospective rate of return for an investment that is high enough to offset what we could lose should we be proven wrong. Our position sizes are larger when we find companies that have fallen from favor for reasons that we presume to be transitory. Such companies will hopefully provide us with the necessary two legs to stand on: (1) earnings growth, and (2) multiple expansion. Crescent has made a recent investment in Wal-Mart. We hesitate to discuss it because the position is so small, but we thought it beneficial to illustrate some of what we are finding to do in this current environment of relative value. We look at Wal-Mart as a bond with an infinite maturity

³ $11.1\% - 4.5\% + 1.8\% = 8.5\%$.

⁴ ISI Group.

⁵ $54\% \text{ historic dividend payout ratio} / 30\% \text{ current dividend payout ratio} = 1.8 \times 1.8\% \text{ current dividend yield} = 3.2\%$.

with a rising coupon. By owning Wal-Mart today, at less than a market multiple, we believe that our future return should be approximately equal to its earnings growth. We believe that, for the foreseeable future, earnings can grow at least 7.0% annually, lower than the 13.5% over the past five years and we do not count on the expansion of its P/E multiple. To this we add an assumed 1.6% return for share repurchases (that have averaged 1.8% over the last three years) and the current dividend yield of 1.4%. Altogether, this should provide a 10% return, but there are no guarantees. Meanwhile, we believe we retain a free option for some good things that could happen, including: P/E expansion, developing a credit-card business in the U.S. using its \$250 billion in domestic sales as a springboard, foreign profits repatriated at improving exchange rates should the U.S. dollar weaken, and improving their mediocre return on investment in foreign markets. Wal-Mart may not be an exceptional rate of return, but we believe that the risk of owning Wal-Mart is not great and we expect that its market return will exceed that of the stock and bond market over the next five years.

The pricing of risk lies clearly in the temperament of the person doing the evaluating. We, for example, see risk mis-priced in the January 2006 issuance of *Iraqi Sovereign Notes*. If we had some ability to determine that the Republic of Iraq will prove capable of paying back this \$2.7 billion loan — which we don't — then we would certainly demand more than the 9.8% yield-to-maturity with which these notes were issued.

We have been purchasing U.S. Treasury Bills and Notes as a temporary repository until we can commit such capital to investment securities that we believe offer reasonable upside for the risk assumed. We don't know where rates will peak, but we believe it prudent to allocate a portion of our cash holdings to medium-term Treasuries as rates rise to the highest level seen since the first quarter of 2002. Investing capital for 5-years at 4.8% may be less than a stock-market return, but it may not. Our feeling is, why assume market risk, if the potential upside does not warrant it?

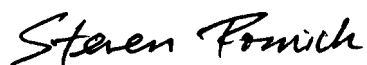
Consumer spending remains robust despite rising energy outlays and higher borrowing costs. In

the face of rising interest rates, house prices continue to rise, albeit at a slower rate than the last few years and more than enough for individuals to use their homes as piggy banks. Such price appreciation has given homeowners the flexibility to take cash out of their home. We have seen estimates that Mortgage Equity Withdrawal (MEW) totaled \$700 billion in 2006. If so, that would represent 5.6% of the estimated 2006 Gross Domestic Product (GDP). We have seen estimates that half of MEW finds its way back into the economy, that is, it is spent, not saved. If so, housing would account for 2.8% of 2006's estimated GDP increase of 4.0%. House price appreciation has been a huge locomotive in the economy. In a weak or even flat home price environment, people will not be able to withdraw equity to buttress their lifestyle. Many will see their disposable income decline as adjustable-rate mortgages re-price at higher interest rates and some will lose their homes. As much as \$1 trillion in adjustable-rate mortgages will be reset in the next year or two. Unfortunately, we cannot envision the offset.

Absent an ability to divine the future, we rely on the time-proven method of buying what we perceive to be good value. We hunt and wait until such value appears. Waiting can be uncomfortable. Clients, other professional relationships, friends, and family may question the direction, especially when the conventional wisdom is doing something different, maybe something that is currently more profitable. However, we do not do what we do for comfort, we do it to make our clients money and because we enjoy the process. The strength of our method is its simplicity and practicality, in that it can be repeated over time. No matter what the level of the overall stock market, we will put capital to work when we feel the risk and reward justify our doing so. This explains our more fully invested position in 2000 when we were able to find inexpensive securities to purchase, despite elevated market levels. Optimism and complacency reign, while we await pessimism and fear, the friend of the value buyer and the enemy of the speculator. The more bearish investors are, the greater the overall prospective returns. We live by the saying, "Once you've learned how to succeed, then quit trying."

We have a laundry list of concerns — not long on optimism here. Margins for most companies are above normal, which leads people to think they are buying values on current earnings, which we believe is not true. Valuations based on normal earnings are high. The yield curve is flat, with both short and long rates moving higher. A range of data is pointing to spreading weakness in housing markets. Volatility in the financial markets is near all-time lows. Volatility is now even lower than the previous low before the Long-Term Capital blowup in 1998. Bullishness is one standard deviation from the mean. Most importantly for us, our screens are turning up a small number of stocks and of these, few meet the required standards. We firmly believe that our value standards are there to be followed, even if it temporarily means that cash builds.

Respectfully submitted,

A handwritten signature in black ink that reads "Steven Romick". The signature is written in a cursive, slightly slanted style.

Steven Romick
President
April 23, 2006

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Fund shares are presently offered for sale only to existing shareholders and to trustees, officers and employees of the Fund, the Adviser, and affiliated companies, and their immediate relatives.

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