LETTER TO SHAREHOLDERS

Dear Fellow Shareholders:

Crescent returned 0.44% in the third quarter and 6.20% year-to-date. This compares favorably to our 60% Russell 2500 and 40% Lehman Government/Credit benchmark and places the Fund ahead of most stock market indexes thus far in 2004. Please refer to the comparative return information at the end of this letter.

The stock market isn't rife with value. We realize that for the loyal reader of our missives this statement does not come as a shock. We find it difficult to come up with new ways to say the same thing. For the more recent reader, we have found it challenging to put capital to work for the past year or so. Although corporate earnings are somewhat higher, the stock market is higher as well. The upshot: valuations still are not cheap enough for us to be in good conscience fully invested, knowing that the margin of safety of such an action poses the risk of a serious erosion of capital. I can't remember which pundit recently said that investors today are not getting risk-free return, rather they are more likely to achieve return-free risk. We remain with a large cash cushion as we await the inevitable, but not necessarily timely, opportunities.

Although we have spoken at length regarding our large cash position, there are other notable trends worth reporting at this time. First, the market capitalization of your Fund's average investment has increased to a new high. Small-capitalization stocks have been less expensive by most valuation measures when compared to mid- and large-capitalization companies since I began the Crescent Fund more than eleven years ago. We do not see a notable valuation differential between companies of varying market capitalizations today. All things being equal, we have chosen to migrate up in size. The weighted average market capitalization of your Fund today stands more than three times higher than its low at $3.1 billion, its highest ever — larger, but certainly not large-cap.

We said that the stock market did not appear that inexpensive to us. However, that stock market is the U.S. market. We cannot forget the rest of the world in this increasingly global economy. We have been uncovering better values abroad in the recent months. This is not our first foray overseas, as we have invested in the public shares of foreign companies for many years. Recently though, the percentage allocated to foreign shares has increased. We had 7.8% invested overseas at quarter-end.[1]

With our patience sorely tested in the U.S., we have uncovered what we believe to be great valuations in three very good businesses in the United Kingdom. These recent investments are much less expensive than the average U.S. company and pay a far higher dividend yield. The table below reflects the comparative valuation and dividend yield based on our average purchase price.[2]

	Recent UK Investments	Russell 2500	S&P 500
Price / Earnings Ratio	11.0x	23.0x	19.0x
Dividend Yield	5.0%	1.3%	1.8%

We don't pretend that investing in a foreign country with less stringent regulatory oversight, more lax corporate governance, different accounting conventions, and a different language is without risk. We hope to minimize this risk by purchasing public businesses with good balance sheets at deep discounts to what we would have to pay for a similar business in the United States. Our recent UK investments trade at P/Es that are almost a 50% discount to the U.S. market, have higher returns on shareholders' equity, and a dividend yield that is about 3 times as large. We are getting paid to wait. Dividends accounted for approximately 40% of the total return seen in the U.S. stock market over the last 75 years. As we continue to expect a low return environment for a number of years, a 5% dividend yield should prove an intelligent starting point in achieving good investment returns.

We also do not mind having more exposure to currencies other than the U.S. dollar. As we have prattled in the past, we believe that there is a good chance we could see in the coming years a continued erosion in the value of the dollar.

[1] Percentage is gross long investment.
[2] P/E calculation is predicated on 2005 consensus estimates.

There does, however, appear to be a language barrier even in England. We found it necessary to ask the CEO of one of our recent investments to repeat what he said in American. Wasn't it Oscar Wilde who said, "Two countries separated by a common language?" We observed a tell-tale sign that we use words differently when a British executive made reference to his cell phone's ear bud that had fallen as a "dangly bit."

We spoke of our recent forays into technology in our second-quarter shareholder letter. To date, our results have been mixed. We pointed to our inability to time the technology cycle of NAND flash cards and the category-dominant company with 40% share, SanDisk. Our average cost of $21.28 looked prescient as its stock price rallied to $31.42 just a few months later. We sold 20% of our stake outright but we effectively sold more as cash was contributed to the Fund during the quarter. If cash is contributed and we do not add to an existing position, the position size is reduced as a percent of the portfolio. It is not only an effective sale, but proves a tax efficient one as well. Nevertheless, subsequent to quarter-end, SanDisk announced that pricing was declining more quickly than anticipated and that to meet what still was tremendous demand, the company outsourced more than expected. SanDisk's stock price returned back to our purchase levels. So much for prescience. We continue, however, to believe in the longer-term trends for larger capacity memory cards and purchased additional stock accordingly.

We invest with a view down the road and thus, find it outside our capability to "time" either the stock market or individual investments. We have had a large position in energy services for some time and although we have modestly reduced the position size, we continue to believe that we will liquidate our stake at substantially higher prices. A decline in oil prices will likely cause these stocks to decline in price. We would not be surprised to see such a decline. If, for example, Ensco International were to trade from its quarter-end price of $32.67 back down to our $24.97 cost, a 23.4% decline, then Crescent would be negatively impacted by 0.87%.[3] We believe in the longer-term structural supply/demand issues in the oil service sector that we anticipate will allow for greater future earnings and higher stock prices. To sell the stock at today's prices, pay the capital gains tax (much of it short-term) and hope to repurchase it at lower levels is more than we can ask of ourselves. If we sold our stake and the stock dropped in price we may look like heroes temporarily. However, if the stock price doesn't decline to a level where we would repurchase it and subsequently it rises to our price target, then we would have missed out on the upside. We do our best to insulate ourselves from the visceral vacillations of the stock market.

This means, of course, that we are willing to absorb some volatility. Another example would be our recent investment in Countrywide Assured, PLC, not to be confused with Countrywide Financial Corporation. The Countrywide we own is the largest residential real estate broker in England. We have been accumulating a position at about 10x what we believe are "normalized" earnings with no value placed on the potential accretion that we discuss further on. The British real estate market has been weak lately and transaction volume is approaching 25-year lows. This provides us with an opportunity to build a position. We do not know for sure that the company's stock price will rise from here, but it may. We would prefer to see it decline as we would build our position at lower prices. We would not be surprised to see the stock down 30% from current levels. That may seem like a large number but if it were to occur it would allow us to have a larger position at a lower average cost. We would rather double our money on a 4% position than a 1% position.

Countrywide has three other businesses, two of which have tremendous growth opportunities. The Conveyancing business, akin to our title business in the U.S., is using technology to further their competitive advantage, lower their costs, and improve their efficiency. The division loses a small amount of money today but after spending time in central England at the Conveyancing group's main offices, we believe that it could contribute 10-20% to earnings in a few years. The Surveyance and Valuation division, also the largest in the country with an 18% market

[3] A 23.4% decline on a 3.73% position in Ensco International.

share, provides home appraisals and other legally required documentation. In addition to technological advancements that should reduce costs and allow them to gain further market share, Parliament has a bill that seems likely to receive Royal Assent that could help earnings in this segment to more than double and that could add more than 50% to current earnings. We believe that multi-year growth and the potential for its stock price to provide rewarding returns in a few years justifies the near-term downside risk we have assumed. We are not smart enough to pick the bottom. Meanwhile, while we wait for the story to unfold, Countrywide is paying us a 5.1% dividend yield.

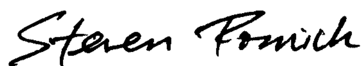
We believe it highly unlikely that the U.S. stock market will approach the 11.2% returns seen over the past three quarters of a century for two reasons. One, we do not believe the economy will expand at the same rate in the future as it has in the past. Two, dividend yields are a far cry from the 4.3-4.5% that contributed to the aforementioned total historic return. Shareholders and managers of public companies frequently engage in the perennial conflict of how corporate cash flow should be spent. Each case is different but the question that needs answering is, "who can achieve a better return on their investment?" Too often, companies reinvest their cash in low-returning businesses. In today's tax environment, we believe managers have a more difficult case to make. If dividend payout ratios, which are hovering near historic lows, were returned to a mean level, dividends would approximate 3%, 60% higher than they are today.[4] To throw another wrinkle into the equation, we believe that the quality of corporate earnings is less than it's been in the past and, as a result, the effective payout ratio is higher than it appears.

A recent study co-authored by Professor Campbell Harvey of Duke University's Fuqua School of Business surveyed 401 chief financial officers. We share some of the distressing findings with you. "The survey found that companies routinely employed legal accounting gimmicks to hit their numbers. But the study also found that 78% of CFOs would give up real economic value in exchange for artificially smooth earnings — including deferring spending and selling off patents. More than 55% said they would delay starting new projects to meet earnings targets."[5] Sadly, sacrificing long-term earnings is determined by too many to be an acceptable business practice.

We realize through our many conversations with companies that inflation is lurking around the corner. Many companies have contracts that lock in their raw material costs for a specified period of time. As we know, such costs have been rising. New contracts will be established at higher prices and when it comes time to renegotiate those contracts, a company will do its best to pass through price increases to the customer, which will result in inflation should they meet with success. Failure to achieve a price increase to offset the corresponding increase in production costs will negatively impact earnings. We can envisage the occurrence of either one or both of the above. Either way, there will likely be a higher level of inflation that we do not believe is currently priced into the stock and bond markets.

We continue to focus on absolute value, believing that relative value is relatively dumb. As Edwin Lefevre points out in his biography of Jesse Livermore, *Reminiscences of a Stock Operator*, "….a man may see straight and clearly and yet become impatient or doubtful when the market takes its time about doing as he figures it must do. That is why so many men in Wall Street…lose money. The market does not beat them. They beat themselves, because though they have brains they cannot sit tight." Here's to sitting tight.

Respectfully submitted,



Steven Romick
President
October 25, 2004

[4] Nevertheless, there is room for Corporate America to raise payout ratios and deliver larger dividends.
[5] *Financial Times*, Stephen Schurr. July 19, 2004.