Holt Capital
Partners, L.P.

Third Quarter Financial Market Commentary

"Ninety Days in Ninety Seconds"

September 30, 2011

Fear Trumps Fundamentals

- The tug of war that we referenced last quarter between strong company-specific fundamentals and suboptimal policy responses continued throughout the third quarter. Unfortunately, the fear and the uncertainty surrounding the European debt crisis overwhelmed good corporate earnings news during the past three months. Memories of the aftermath of Lehman's bankruptcy are still fresh in the minds of investors and fears that Greece's debt crisis will result in similar collateral damage throughout peripheral Europe have put traders and investors on the defensive.

Three Unquantifiable Fears

- The financial markets are struggling with three macroeconomic worries that are difficult to quantify. The European debt crisis is at the top of the worry list for most investors. The potential domino effects of a default by Greece cannot be accurately predicted, which is partly a result of the lack of transparency with respect to the balance sheets of European banks. Secondly, gridlock in Washington is no longer viewed as a perversely positive condition, but rather a symbol of political and fiscal irresponsibility. Finally, debate continues to rage over whether the confluence of these global events will push the U.S. economy into a new recession. The absence of strong and timely leadership by policy makers regarding these issues has spawned a global crisis of confidence. This lack of confidence in governmental institutions spilled over into the financial markets during the third quarter and produced lower stock prices and higher volatility.

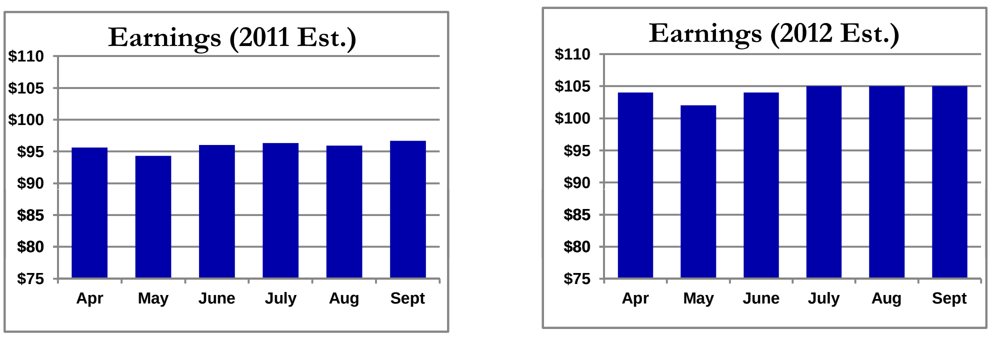
Roadmap To European Stability

- Economists generally agree that three major issues need to be resolved in order to bring stability to the European debt crisis. Peripheral Europe needs a bigger aid package, many European banks need to be recapitalized and an orderly default by Greece needs to be orchestrated. The magnitude of these actions, combined with the complexities of the seventeen country governing mechanism of the European Union, raises significant concerns about whether the political will exists to achieve a positive economic outcome. In the absence of a clearly articulated consensus solution, investors have been assuming a worst case outcome to this crisis.

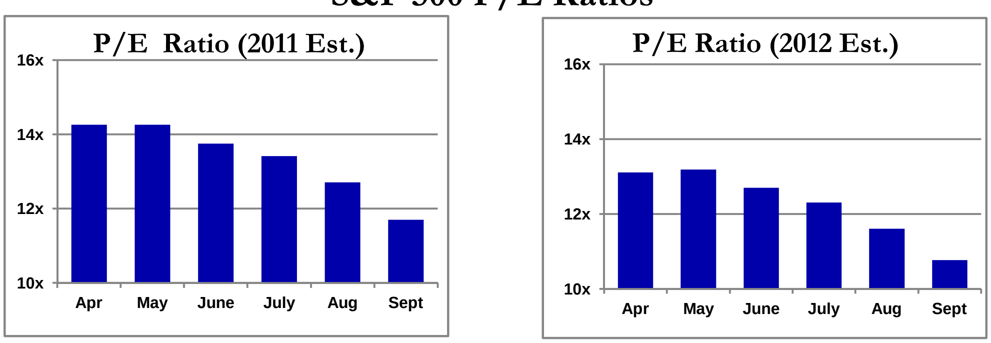
EARNINGS AND VALUATIONS

- Corporate earnings have been much more resilient over the past several months than one might have expected. An argument can be made that investor expectations for 2012 earnings have fallen much more than the published estimates would imply. The counterargument is that if estimates must be adjusted downward, then that process will present an additional headwind for the stock market. I believe that this uncertainty sets up a market environment where reported earnings that are simply close to consensus estimates over the next several quarters will be viewed as positive surprises. Low valuations are just one of the myriad of factors that influence stock prices. However, if earnings estimates represent reasonably accurate forecasts, price-to-earnings ratios are currently at the same level as early March 2009, *which was at the bottom of the bear market.*

S&P 500 Earnings Estimates



S&P 500 P/E Ratios



A VOLATILE QUARTER FOR THE STOCK MARKET

- Although most of the decline in stock prices occurred in late July and early August, the daily volatility made the decline feel as if it were unending. While virtually all stocks fell during the quarter, traditionally defensive sectors such as utilities and consumer staples produced the greatest price stability. Companies with high expectations for earnings growth, either from organic growth or cyclical exposure, declined sharply as the slowing economy reduced earnings visibility. Clearly, when investors perceived earnings risk, whether it was company-specific, commodity-related, or a function of industry factors, their collective reaction was to sell first and ask questions later. These volatile and divergent trends can be seen on the following graphs.

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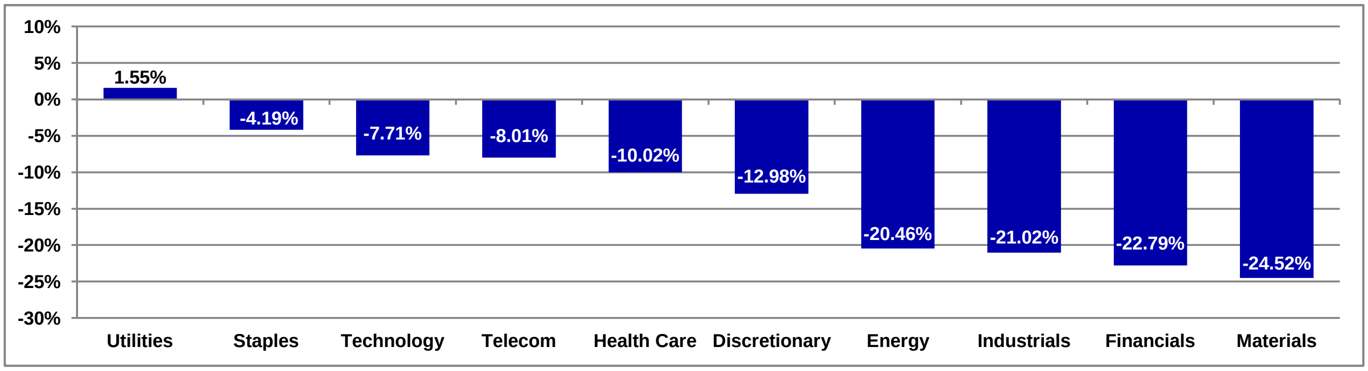
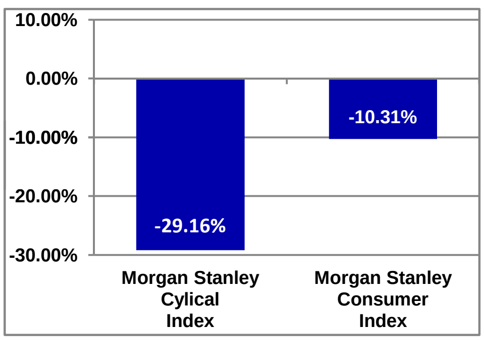
Third Quarter Performance (including income)

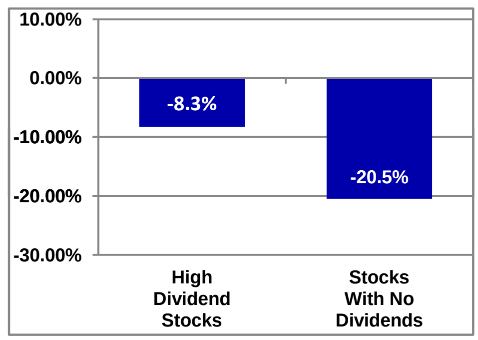
By Economic Sector



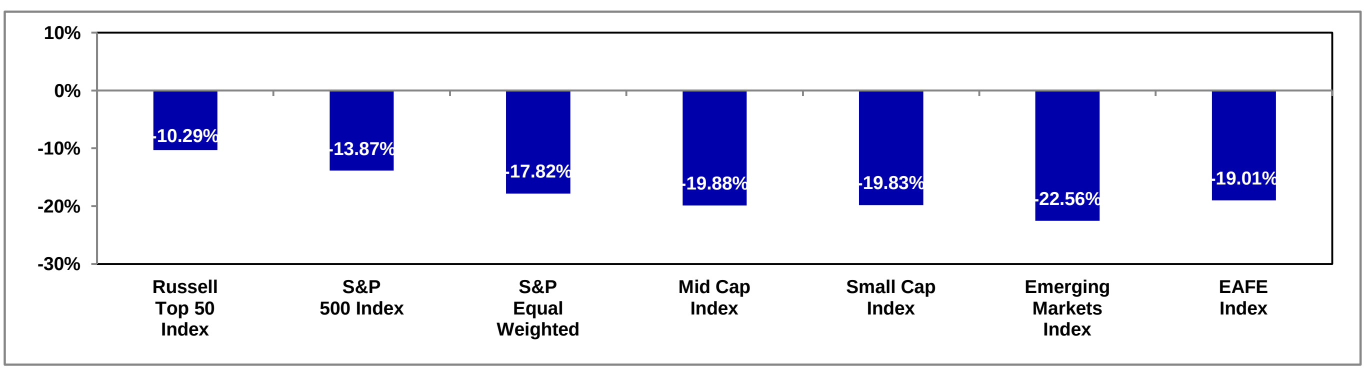
By Economic Sensitivity



By Dividend Yield



By Market Capitalization and Geography



Investment performance comparisons during the third quarter were generally a mirror image of the two and one-half years since the bottom of the bear market in March 2009. The weakest performing groups during the quarter were typically the best groups over the entire time period and vice versa.

TRADERS VERSUS INVESTORS

- The downside of 24/7 news coverage is that incremental news often inspires incremental action and transforms investors with long time horizons into short term traders. Cash-rich corporate balance sheets are the friend of long term investors, but those high quality financial characteristics are irrelevant to traders. The same is true of strong management teams, low valuations and dominant market shares. These are characteristics that drive long term value in the stock market, but don't generate much excitement among the talking heads of the financial media.

CONCLUSION

- The stock market exhibited a heightened level of volatility during the third quarter in reaction to global economic uncertainty. While the operating and financial results of domestic companies are undoubtedly exposed to these risks in the short term, significant differences exist between the current crisis and the Great Recession of 2008. The lessons from the 2008-2009 period have resulted in much improved balance sheets for non-financial companies and much higher levels of liquidity at financial firms. These fundamental changes should buffer any impact from the European debt crisis. Recent economic reports indicate that while the domestic economy remains weak, conditions are not deteriorating. This is an important distinction and supports our firm's view that the U.S. will avoid a double-dip recession.

  While these are difficult times, they are also times of great opportunity. For investors with long time horizons, the first half of the old adage "buy low and sell high" seems like timely advice.