

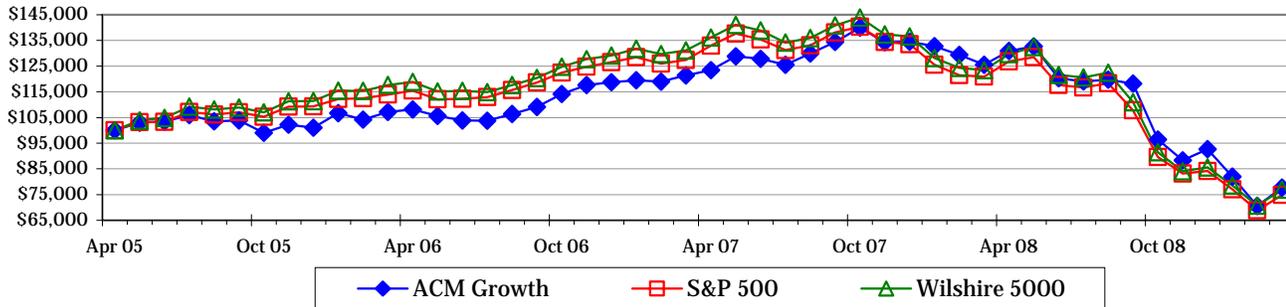


Athena Capital Management

Cumulative Growth Performance

Performance as of 3/31/09	Year to date	1 year	2 years	3 years	Since inception (4/30/05)
ACM Growth	-16.16%	-38.07%	-35.94%	-27.43%	-22.26%
S&P 500	-11.01%	-38.09%	-41.23%	-34.28%	-25.15%
Wilshire 5000	-10.12%	-37.69%	-41.32%	-34.61%	-23.10%

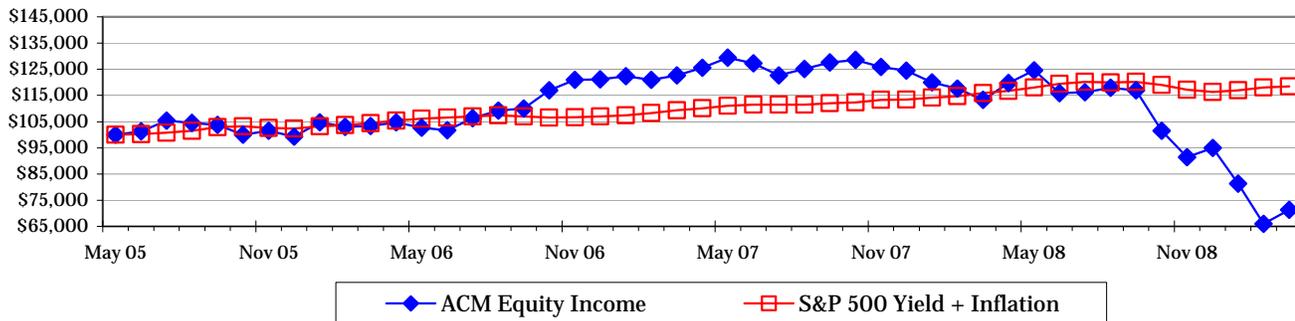
Comparison of the change in value of \$100,000 investment in ACM growth versus S&P 500 and Wilshire 5000



Cumulative Equity Income Performance

Performance as of 3/31/09	Year to date	1 year	2 years	3 years	Since inception (5/31/05)
ACM Equity Income	-24.93%	-37.05%	-41.89%	-31.00%	-28.69%
S&P 500 yield + inflation	1.93%	2.25%	8.41%	13.55%	18.53%

Comparison of the change in value of \$100,000 investment in ACM equity income versus S&P 500 yield plus inflation



Past performance is no guarantee of future results. As in all equity investing, there is a risk for potential loss. Performance results were calculated after deduction of all management and trading fees. Portfolios were valued daily, trade date accounting was used, accrual accounting was used for dividends. Time-weighted rates of return that adjust for significant cash flows were used. Returns from cash were included. For ACM growth accounts, the S&P 500 was used as benchmark because it was deemed the most readily available and widely known growth composite. It should be noted that ACM growth accounts were more concentrated, sometimes had higher cash investments, included international investments, and were invested in companies with different market capitalizations and characteristics than the S&P 500. Although these differences existed, the accounts shown were invested for growth and not set to achieve any particular market capitalization or exposure. ACM equity income accounts used S&P 500 yield plus inflation because this combination of the most readily available equity yield and growth with inflation was deemed the most relevant benchmark for equity income accounts. These accounts are designed to provide an equity yield for income plus growth to maintain purchasing power over the impact of inflation. Both out- and under-performance of accounts shown were due both to individual security selection and to concentration of investments. Neither market nor economic conditions contributed significantly to account performance relative to benchmarks. ACM growth and equity income portfolios include all portfolios under management during all periods of management and include portfolio performance as of the first day of management. The accounts depicted used no leverage or derivatives. The S&P 500 and S&P 500 yield plus inflation returns shown do not reflect commissions, trading expenses, or management fees, which would have reduced both benchmarks' results.



Athena Capital Management

April 16, 2009

The stock market continued to tumble this quarter, as did our portfolios. News on the economy went from bad to worse—particularly unemployment. All is not lost, though, as economic glimmers of hope appeared at quarter end, and our investment prospects have never looked better.



This quarter's letter will discuss our performance, the market and economic outlook, some thoughts on markets, a warning about impending inflation, and our investment in Mohawk Industries.

Performance this quarter

Growth portfolios under-performed over the last quarter, but continue to out-perform over longer periods (1, 2 & 3 years and since inception).

Performance was excellent in the first half of January, and the last half of March, but dismal in between. Strangely, there seemed to be little rhyme or reason for these fluctuations other than knee-jerk reactions by short term traders. Luckily, such traders gave us the opportunity to sell holdings in Wal-Mart, Montpelier, White Mountains and Smithfield, and put that money to better use in Dell, Leucadia and Kimco. **In the short run, volatility is irritating, in the long run, pure gold.**

Growth accounts received out-performance from **Sears Holdings** and **Canadian Natural**.

Sears was one of our worst performers last quarter, just showing how myopic the market can be quarter to quarter. Much to the chagrin of those who would profit from its price decline, Sears stubbornly continues to make money selling merchandise. Sears' reputation is, frankly, far from excellent, but its underlying cash flow tells a different story: it's likely to survive the downturn and turn a tidy profit in recovery.

Canadian Natural, an oil & natural gas producer, benefited as oil prices rose over the quarter. Canadian adeptly allocated capital to heavy oil as natural gas prices declined, benefiting from better pricing in heavy oil, while also bringing its oil sands project online at much lower production costs than rivals. If you dread higher oil prices, remember your portfolio benefits by owning Canadian Natural.

Growth's under-performers this quarter included **Mohawk Industries** and **Ryanair Holdings**. Go figure...they were our out-performers last quarter.

Mohawk declined on worries about its debt load and the housing market. Although Mohawk has a hefty replacement flooring business, the market seems overly focused on the impact of new housing starts. Mohawk has a more flexible cost structure than seems to be recognized, too (see more on this below in the investment spotlight).

Ryanair declined for the same reason Canadian Natural climbed: fuel prices increased. Even though Ryanair is the lowest cost airline in Europe—by a large margin—investors are overly focused on how oil prices will impact it. In the short run, oil price is an issue, but not in the long run.

Equity income portfolios continued to decline this quarter, under-performing our benchmark over every period. Although I'm *very* disappointed in this performance and working hard to improve it, I'm also *extremely* optimistic about our future returns. Several of our holdings cut dividends this quarter, both reducing portfolio payout and leading to price declines—providing a double-whammy of bad news. But, there are good reasons to believe these dividend cuts are temporary, and that resultant price declines are grossly overdone. Only time will tell, but I strongly believe our equity income portfolios will perform very well over the next several years.

Equity income accounts saw out-performance from **Altria** and **Gladstone Commercial** this quarter.

Altria is the parent company of Phillip Morris USA, the producer of best-selling Marlboro cigarettes, and also owns a big chunk of SAB Miller, the beer brewer. Even in bad times, smokers smoke cigarettes and beer drinkers drink beer. The market, this quarter at least, seems to understand this dynamic and was willing to pay up for such stability.

Gladstone is a Real Estate Investment Trust that invests in all types of commercial real estate. Keeping debt low and prudently leasing to good renters benefited Gladstone, especially relative to its competition. Commercial real estate will continue to struggle going forward, but Gladstone looks well equipped to weather the storm successfully.

Equity income's under-performers this quarter were **Kimco Realty** and **Wells Fargo**.

Kimco is a Real Estate Investment Trust invested mostly in strip malls. Investors are worried about how strip malls will do and Kimco's debt load, but I think these concerns are overdone. I consider Kimco to be best in class in their field, and am quite confident Kimco will



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survive and benefit greatly from market turmoil. (Kimco is up over 20% since quarter end.)

Wells Fargo is one of the nation's largest banks. It, too, is best in class, but in a field that is being too broadly painted with the same bad brush. Wells Fargo is well run and rapidly taking on new deposits as customers flee bad banks. On top of this, it was able to purchase its competitor, Wachovia, at a fire sale price. In coming years, we'll almost certainly look back and wish we'd bought even more Wells Fargo. (Wells is up almost 30% since quarter end.)

Market and economic outlook

The S&P 500 was down another 11% last quarter, making this bear market one of the worst declines in history. On the upside, future returns look very good going forward. The market might decline much further before going up, but I'm expecting *average* annualized returns of 12% over the next 6 years—doubling initial investment. With superior fundamentals, I'm projecting our investments will do even better.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	5.6% to 18.5%
S&P-500-yield-plus-inflation (equity income benchmark)	5.3% to 8.3%

How do I arrive at these numbers? Visit "Free Articles" at www.athenacapital.biz to see my 7/12/05 article.

The economy looks dreadful right now, with some reports showing the worst numbers since the Great Depression. Unemployment figures, in particular, are bad and getting worse. Despite this, there is reason for hope. Unemployment numbers almost always bottom *long after* the economy and stock market are many months into recovery. There are glimmers of hope that housing markets may be starting to stabilize and manufacturing may already have hit bottom. I'm not saying happy days are here again, but better days may be closer than it seems.

There's a saying on Wall Street, "no one rings a bell at market tops or bottoms." It only becomes clear in hindsight, long after a new bull market is running, that the proverbial bottom has been reached. It may take time to develop, and we may have another dip—or three—to endure (perhaps into 2010), but at some point the market will start to recover. When it does and everyone realizes it, the biggest gains will have already happened.

Thoughts on the market

When the economy looks dour and stocks are down, we all want assurance. In an attempt to provide that assurance, I've assembled a grab-bag of my thoughts on markets and future returns. I hope it helps you feel calmer about what may lie ahead and excited that such times can be *very* rewarding.

Hindsight bias and regret

Are you kicking yourself for not selling before October 1st, 2008? If so, you're not alone. The tendency to "know" the market was going to crash—with certainty *only* in hindsight—can lead you to feel tremendous regret. Don't torture yourself.

The fantasy of being able to sell before the market crashes and buy before it takes off is as old as time. It's the holy grail of the investing world—everyone seeks it, but no one finds it. And yet, there's always someone who claims to have successfully timed the market. Just because someone gets lucky once or twice doesn't mean they can do it consistently—*no one* can consistently time the market. Remember, even a broken clock is right twice a day. Look at the Forbes 400 list of richest people some time—you won't find a single market timer in the group.



It may seem unfortunate, **but you have to ride the market's ups and downs to gain its long term benefit.** The pain of downside is the price paid for upside.

First, the bad news from history

Looking at historic relationships between market price and business fundamentals since 1872, the market looked around 15% under-valued (i.e. cheap) at quarter end. The bad news: **it's not unusual for it to go from under-valued to even *more* under-valued.**

Looking in the rearview mirror of history, the market hit multi-decade lows in:

- o 1921 (following World War I)
- o 1932 (at the bottom of the Great Depression)
- o 1942 (in the depths of World War II)
- o 1982 (after the high inflation of the 1970's)

Using those market lows as a yard stick, **the stock market could fall another 30% to 50%, with the Dow Industrials at \$3,500 to \$5,500**, to match the worst downturns of the last century. That's not a forecast, just an attempt to prepare you for the *worst* history has shown over the last century.



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Now that I've scared you half to death, let me provide some caveats. As Warren Buffett put it, **if history were the best guide to stock markets, then the Forbes 400 would be full of librarians**; take historical analyses with a grain of salt. Although our current economic landscape looks bleak, it doesn't match up to two World Wars and the Great Depression; it's very unlikely, though not impossible, to get that bad. When the market hits historic lows, it doesn't spend much time there; the market *climbed 173%* within *3 months* of hitting bottom in 1932.

Now, the good news from history

In his most recent shareholder letter, **Warren Buffett provided some historical perspective that I found comforting** enough to repeat here for you.

"Amid this bad news, however, never forget that our country has faced far worse travails in the past. In the 20th Century alone, we dealt with two great wars (one of which we initially appeared to be losing); a dozen or so panics and recessions; virulent inflation that led to a 21 ½% prime rate in 1980, and the

Great Depression of the 1930s, when unemployment ranged between 15% and 25% for many years. America has had no shortage of challenges."



"Without fail, however, we've overcome them. In the face of those obstacles—and many others—the real standard of living for Americans improved nearly *seven-fold*

during the 1900s, while the Dow Jones Industrials rose from 66 to 11,497. ...Though the path has not been smooth, our economic system has worked extraordinarily well over time. It has unleashed human potential as no other system has, and it will continue to do so."

Nice perspective from the second richest guy in the world. This time *is* challenging, but it's nothing worse than what's happened in the past, and such events didn't prevent huge returns for long term investors.

Short versus long term focus

One of the hardest tasks in market crises is to focus on the long term. You can't live in the world today without hearing a lot of bad news. That stream of gloom has a psychological impact that draws our focus away from long range goals and toward the fears and

worries of the present. But, focusing too much on the short term can lead to poor investing results.

You may not know it, but **the average stock is bought and sold within a mere 7 months**. That means current market prices reflect traders' guesses about the next 7 months, not each company's long term prospects. By not following this short term pack, we're free to lock in excellent long term returns. Volatility is an advantage for the prepared.

As long as you don't need your money in the short term, you are free to focus on the tantalizing long term returns we're likely to get.

None of you have short term money with Athena. Knowing stock markets are this volatile, I made sure each of you put only long term money with me. Although recent market swings make it impossible not to notice short term results, it's important to remember our long term goals, and that volatile markets can be very profitable.

"The time of maximum pessimism is the best time to buy"

That's a quote from John Templeton (pictured right), one of the greatest investors of all time. Baron Rothschild advised, "The time to buy is when there's blood in the streets."



Warren Buffett says to "be greedy when others are fearful." **One iron principle of investing is to buy when things look terrible.** I think our current situation qualifies.

If buying when the market crashes works so well, why doesn't everyone do it? Because it feels *dreadful!* It's one thing to look at a stock chart and say that 1932 or 1982 were great times to invest. It's an entirely different thing to live through such times and act when it feels awful. But, that's how great results are achieved.

Our psychology resists the attempt to take bold action in tough times. This makes sense from an evolutionary standpoint—the time to run is when the lion is charging. Disciplined investing asks you to do what millions of years of evolution have led you to dread with every inch of your being. It feels bad, but it's *clearly* the path to superior investing results.



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"...thou hast endured still worse than this"

I hope my thoughts help you feel better about our current situation, and more importantly, excited about our opportunities looking forward.

The looming threat of high inflation

In my first letter to clients in July 2005, I warned that the stock market was over-valued. That warning looked silly for a couple of years, but relatively sound more recently. Now, I have a new warning: beware the looming threat of high inflation.



Inflation results when money is printed faster than underlying economic growth. Our recent economic crisis has led the governments of the world (not just the U.S.) to print and borrow a lot of money. Such actions will lead to inflation in the future, and most likely **a much higher rate of inflation than most people currently suspect.**

Like my 2005 warning, this one is unlikely to look prescient in the short term. Inflation may not show *for years*, but when it does, it's likely to surprise. Be assured, **I am investing your portfolio with such concerns in mind.** Over the long run, equities are excellent protection against the ravages of inflation.

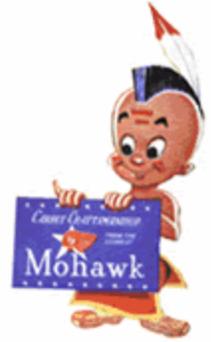
On the other hand, **fixed income investments will be significantly impacted by high inflation** (bonds, notes, CDs, etc.). It's my advice to stay away from long bonds with low yields or without inflation protection. If you want or need to invest in fixed income, use short maturities you can roll over as inflation rises. Don't reach for a couple extra points of yield at the price of being hammered by inflation.

Investment Spotlight: Mohawk

Mohawk started in 1878 when four Shuttleworth brothers brought 14 second hand looms from England to Amsterdam, New York. In 1908, the fledging firm introduced a new carpet, Karnak, which was an instant success. Flooded with orders, the Company's weavers worked four to five years without changing either the color or the pattern on their looms. That made Mohawk one of the most recognized brands in carpeting.

Mohawk is now one of largest producers of flooring products in North America and Europe.

It makes carpet, rug, tile, stone, fiberboard, laminate, carpet pad and hardwood flooring. Headquartered in Calhoun, Georgia, Mohawk produces from factories in Georgia, Oklahoma, Mexico and Belgium. Its products sell through flooring retailers, home centers, mass merchandisers, department stores, and commercial dealers.



You may even recognize a few of its brands: Mohawk, Alladin, Bigelow, Durkan, Helios, Horizon, Karastan, Dal-Tile, American Olean, Quick-Step, Columbia, Century and Universal.

Mohawk serves more than 30% of the flooring market in North America. This benefits Mohawk because the largest players possess lower costs, more efficient distribution, and cheaper financing to purchase small competitors. Unlike steel, microchips and aircraft production, the flooring business is relatively resilient to economic downturns. In tough times like now, Mohawk can scale back production without breaking the bank and then cheaply spin up production when the economy recovers (and, yes, Virginia, it will eventually recover).



Mohawk also benefits from solid management. Several executives have over 30 years experience in the flooring business. They're committed, too, with executives and directors owning over 18% of the company. Most importantly, they have a long track record of profitably growing the business, both organically and through acquisitions. It may sound easy, but buying competitors and operating them more efficiently than previous owners is quite an accomplishment. Mohawk's team has successfully done this *for decades*.

Mohawk has grown revenue per share 12% and profits per share 21% over the last 10 years (not including 2008). During that time, it averaged returns on equity of over 16%, showing its strong business economics. Usually, a profile like that sells at a high price, but the real estate crash has allowed us to buy Mohawk with a 9% recessionary earnings yield and a 25% recovery earnings yield. ... ♪ "nice work...if you can get it...and you can get it if you try" ♪.



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When scared investors throw out everything related to real estate, it's time to look through their garbage. There we find Mohawk, with excellent economics, good management and a valuation that



severely under-estimates potential value. Like a dumpster diver, I'm quite happy to find this salivating value in other investor's rubbish.

Until next quarter

Thank you for your business. I understand how much patience it takes to hold on through this market roller coaster ride, and am very confident in saying it'll be well worth the white knuckles and grimacing at quarterly statements.

The next year or two will be an epic opportunity to invest. Stock markets go through this type of upheaval infrequently, but it is the *best* time to invest and have money invested. I've never been so excited to be a professional investor, or to be presented the opportunities I'm now seeing.

If you know anyone who could benefit from my investing approach, please send them my way. I'm always happy to talk to prospective clients and provide advice (even if someone doesn't meet my \$100,000 client minimum). Referrals from clients and prospective clients are always welcome.

If you'd like to hear my thoughts on markets between quarterly letters, please feel free to visit my blog: www.mikerivers.blogspot.com. I've received a lot of positive feedback that people find my blog fun to read, brutally honest, informative, and even uplifting, which is nice at times like this.

As usual, feel free to call or write with any questions you may have. I love to hear from clients and prospects, and would be happy to provide any support or advice you're looking for.

Respectfully yours,

Mike

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