

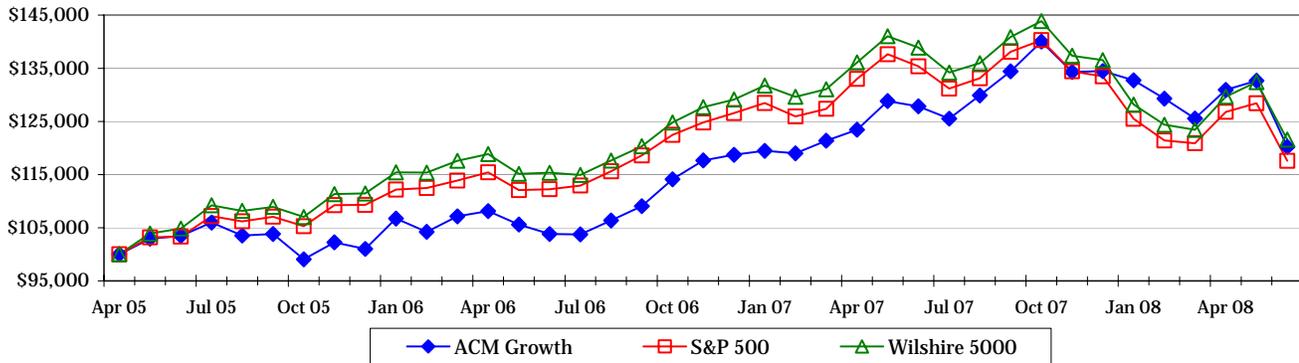


Athena Capital Management

Growth Performance

Performance as of 6/30/08	Year to date	1 year	2 years	3 years	Since inception (4/30/05)
ACM Growth	-10.62%	-5.98%	15.79%	16.18%	20.20%
S&P 500	-11.91%	-13.12%	4.77%	13.82%	17.60%
Wilshire 5000	-10.95%	-12.46%	5.41%	15.98%	21.59%

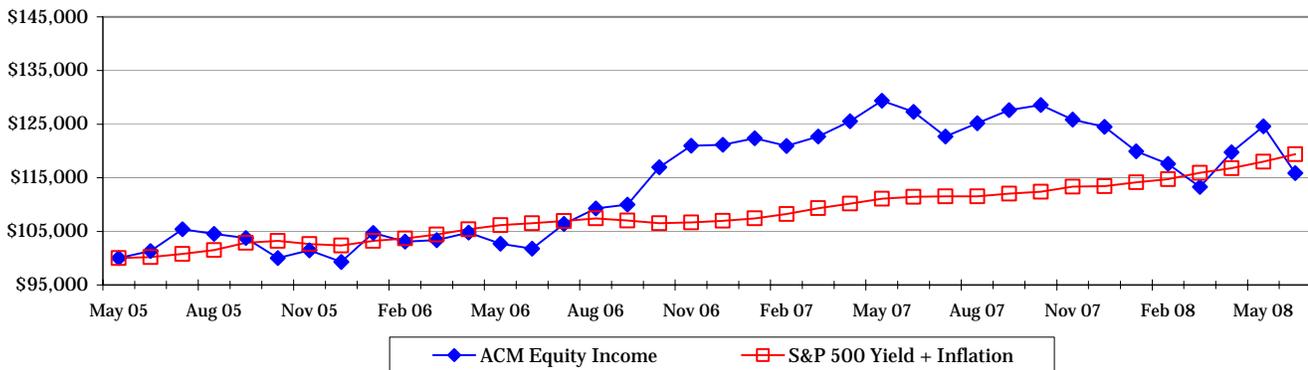
Comparison of the change in value of \$100,000 investment in ACM growth versus S&P 500 and Wilshire 5000



Equity Income Performance

Performance as of 6/30/08	Year to date	1 year	2 years	3 years	Since inception (5/31/05)
ACM Equity Income	-6.94%	-8.98%	13.85%	14.32%	15.85%
S&P 500 yield + inflation	5.27%	7.13%	12.12%	19.16%	19.41%

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. 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

July 16, 2008

The market is down significantly, and I have *never* been more optimistic about our future returns. I believe this is a wonderful time to invest in our holdings.



In this letter, I will discuss our investments, my market and economic outlook, the Parable of Mr. Market, and our investment in Ryanair.

Performance this quarter

Growth accounts continued to out-perform the S&P 500 since inception. After positive returns in April and May, the market turned so negative in June that it wiped out the benefits of the prior two months. Although such downdrafts are unpleasant, they are not at all unusual. I can't say when the market will recover, but I can say that every historical downturn like this has been an outstanding time to invest.

Even better, I think our investments are significantly better than the market. The businesses we own have better economics, better management and better valuations. Prices will not instantly reflect these characteristics, but I strongly believe they will in time. I've positioned our portfolios to benefit significantly when the inevitable economic recovery does appear.

Growth accounts received out-performance from **Canadian Natural Resources** and **POSCO** this quarter. Canadian Natural is an oil and gas exploration and production company with a significant new oil sands project coming on line in the 3rd quarter. Oil and gas is hot, and this made Canadian Natural's stock soar 47% this quarter.

POSCO is the 4th largest steel manufacturer in the world (it's based in South Korea). Steel prices have been high both due to high input costs and high demand for steel products. Being by far the largest steel producer in Korea and being located between Japan and China has significantly benefited POSCO. I expect POSCO's low cost production and high end products (like stainless steel) to continue benefiting shareholders over the long run.

Growth's under-performers this quarter included **Sears Holdings** and **USG Corp.** Sears Holdings includes Sears USA, Sears Canada and Kmart. Its retailing business is struggling operationally, and this is being exacerbated by credit pinched consumers who are hurting from high energy costs and shrinking real estate values. Lucky for Sears, they have *very* valuable real

estate underneath many of their stores and the financial wherewithal to last through an economic downturn. It may take some patience, however, to see Sears' price recover.

USG is the nation's largest wallboard producer. The tanking real estate market, both residential and commercial, has caused wallboard demand to crash. This has sent both wallboard volume and prices to the floor. When real estate recovers (barring the end of the world, it *will* recover), USG will probably use its position as the lowest cost provider of wallboard in North America to make a stunning recovery. This investment, too, may take some patience.

Equity income performance this quarter was much better than last quarter. After a stellar April and May, our portfolios suffered a hard June. Despite this up and down, we managed to squeeze out a gain this quarter. On the downside, this out-performance was not enough to raise "since inception" results back above our benchmark. I remain confident we'll get back above the benchmark soon, although when cannot be predicted precisely.

Equity income accounts saw out-performance from **National Presto** and **ConocoPhillips** this quarter. Although National Presto's appliance business is feeling the economy's pain, its defense and absorbent products are making up for it and then some. It continues to win defense contracts and execute well in all areas. This led to a 22.5% rise this quarter.

ConocoPhillips, like Canadian Natural, benefited significantly from higher energy prices. ConocoPhillips is one of the largest natural gas producers in North America, and natural gas prices climbed 28% this quarter. Not too surprisingly, this led ConocoPhillips to rise 24% in price.

Equity income's under-performers this quarter were **Berkshire Hathaway** and **Pfizer**. Berkshire seems to have declined for a number of reasons: a soft market for insurance premiums, worries that Warren Buffett has lost his edge, concerns about holding too much cash, and declines in the value of some of its holdings. Because Berkshire is one of the best companies in the world and run by one of the most brilliant investors ever, I believe it will recover nicely in time.

Pfizer continues to be plagued by worries about its pipeline of new products. Added to this, some have become concerned that management isn't up to snuff. The amount of cash generated by this business, its strong dividend and the optional upside of new blockbuster drugs make me confident that Pfizer, too, will recover.



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Market and economic outlook

The S&P 500 did its best to imitate a roller coaster this quarter, climbing 8.9% in April and May and then plunging 11.1% by the end of June. The more the market declines, the better my forward projections look, and, as you can see below, they look better this quarter, but not compelling. Importantly, our investments look much better positioned than the market, although the ride will probably be quite bumpy.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	-2.9% to 8.5%
S&P-500-yield-plus-inflation (equity income benchmark)	3.8% to 6.8%

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

Government stimulus checks seemed to cause some economic improvement this quarter, but that will likely prove temporary. Retailers, especially at the discount end, saw boosts from consumer spending that's almost certainly due to government checks. Unfortunately, that boost will not last because the stimulus provides only a one-time benefit. Consumers will have to get their finances back on track before sustained consumer spending revives.

The banking sector continues to struggle. Banks are tightening credit standards and working hard to rebuild their balance sheets. They will probably face difficulties doing so as consumers and businesses struggle to repay loans of all types. In time, banks will get their house in order and restart normal lending levels. Until then, I believe the economy will continue to flounder.

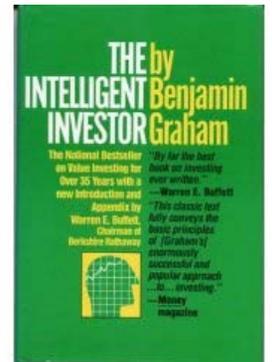
The housing market is working out its problems. Although sales prices are plunging, sales volume is starting to show signs of life. It's impossible to know the timing on something like this, but home prices will eventually hit a point where demand outweighs supply. I believe this will happen late this year or early next year. When it does, that will signal the beginning of recovery both for consumers and banks.

As Warren Buffett says, you pay a high price for a cheery consensus. That means the time to invest in an area is when no one else wants to touch it. Not surprisingly, this means I'm finding interesting investments in the consumer goods, finance and housing sectors. I don't know anyone who can pick market

bottoms, so the best policy is not to try. Instead, the thing to do is focus on good businesses selling at good prices and hold until price reflects underlying value. This always takes patience, but such patience is always rewarded (and sometimes significantly). I believe *this* is one of those times and I'm very excited about our long term returns going forward.

The Parable of Mr. Market

One of the best investing books ever written, *The Intelligent Investor* by Benjamin Graham, presents the best way to think about investing in the stock market. In it, Graham strongly recommends that investors think of themselves as part owners of businesses rather than renters of stocks that trade on an exchange.



One section is so well written I'm simply including it in this letter (bold emphasis mine):

*Imagine that in some private business you own a small share that cost you \$1,000. One of your partners, named Mr. Market, is very obliging indeed. Every day he tells you what he thinks your interest is worth and furthermore offers either to buy you out or to sell you an additional interest on that basis. Sometimes his idea of value appears plausible and justified by business developments and prospects as you know them. **Often, on the other hand, Mr. Market lets his enthusiasm or his fears run away with him, and the value he proposes seems to you a little short of silly.***

*If you are a prudent investor or a sensible businessman, will you let Mr. Market's daily communication determine your view of the value of a \$1,000 interest in an enterprise? Only in case you agree with him, or in case you want to trade with him. You may be happy to sell out to him when he quotes you a ridiculously high price, and equally happy to buy from him when his price is low. **But the rest of the time you will be wiser to form your own ideas of the value of your holdings, based on full reports from the company about its operations and financial position.***

The true investor is in that very position when he owns a listed common stock. He can take



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*advantage of the daily market price or leave it alone, as dictated by his own judgment and inclination. ... Basically, price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. **At other times he will do better if he forgets about the stock market and pays attention to his dividend returns and to the operating results of his companies.***

That's the best way to think about the stock market—as a manic depressive partner who offers daily price quotes that may be low, fair or high relative to fundamentals.

As an example of Mr. Market's disposition and how it can be exploited, consider the case of Fairfax Financial from March 2005 until March 2008. During this time, one estimate of Fairfax's value—called "book value"—was down 25%, then up 83%. At the same time, the stock price of Fairfax went down 46%, then up 244%!

Fairfax's stock price was twice as volatile as underlying fundamentals!

Is it possible that Mr. Market misjudged the short term problems at Fairfax? Did a 25% drop in book value merit a 46% drop in price? Should an 83% increase in book value cause a 244% rise in stock price? I don't think so. Mr. Market is manic depressive indeed!

A drop in stock price—even a significant drop—does not necessarily mean an investment is bad.

It may merely mean Mr. Market has lost his head and is focusing on short term bad news. The same can be said when prices increase. Mr. Market may simply be overly optimistic and it may be best to sell your shares to him.



Investing is as much a matter of psychology as analysis. The parable of Mr. Market helps me focus on business fundamentals instead of the market's wild price swings. I hope you, too, find this parable helpful the next time Mr. Market gets carried away and you're feeling worried about the future.

Investment Spotlight: Ryanair

The airline industry is horrible. Warren Buffett (Berkshire Hathaway) said the airline industry, as a whole, has never made *any* money, and that someone who shot the first plane down at Kitty Hawk would have

been doing investors a favor. Richard Branson (Virgin Records/Mobile/Atlantic) once said the easiest way to become a millionaire was to start out a billionaire and then buy an airline. If the airline business is so terrible, then why do I like Ryanair, the largest airline flying to and from destinations within Europe?

Ryanair is the lowest cost provider in what is basically a commodity business. In a commodity business, people don't care who they buy from, they just want the lowest price. Like buying gas for your car or wheat flour to make bread, you're more likely to focus on price when buying an airline ticket. And, Ryanair is Europe's lowest cost airline by a wide margin.

Ryanair has done a lot of smart things to become the lowest cost provider. For starters, they're based in Ireland where corporate tax rates are half of Europe's. They buy all the same type of jets from Boeing—737s—allowing them to save costs on aircraft, maintenance and crew training. They save fuel costs by operating the latest and most fuel efficient 737s over their optimized point-to-point route network. They operate out of secondary and tertiary airports instead of primary airports where landing and parking fees are higher. The result is a cost per seat mile that's *one-half* of Southwest Airlines—the *second* lowest cost airline in the world!



Ryanair is benefiting from inefficient competition and a deregulating airline industry. Europe's so-called "flag" airlines (British Airways, Lufthansa, Air France, etc.) act like government monopolies with inefficient route networks and high legacy costs. Europe is slowly deregulating its air transport industry, but the flag airlines are fighting deregulation tooth and nail. Ryanair benefits because the flag airlines are more expensive, lose more bags and have fewer on-time departures. Deregulation and slow-to-adapt competition allows Ryanair to serve more destinations and more customers with low fares and better service.

Ryanair has been reducing costs every year and passing those savings on to customers. Like Wal-Mart, Ryanair knows that reducing price increases demand, and they've been growing their passenger traffic by over 20% a year for the last 7 years! Ryanair is expanding their revenue base by offering additional services like low cost car rentals, hotel reservations and in-flight phone and internet access.



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Management at Ryanair is outstanding. Together, they own over 20% of the company, so they're committed to the company's long term success. They've executed well in aggressively taking on old regulations and resistance from Europe's "flag" airlines. Ryanair's management is everything I want to see in a management team—passion, competence, integrity and meaningful ownership.



Ryanair's stock price is cheap because Mr. Market is worried about high fuel costs and fewer passengers per plane. Ryanair is facing the same high oil costs we all are, and so is Ryanair's competition. Being the lowest cost provider is an advantage, especially when an industry's largest cost—oil in this case—is higher than usual. Europe's airlines are carrying fewer passengers per plane because its economy is slowing, leading marginal customers to fly less. But, this slowing is only temporary, so when Europe's economy recovers (and it *will*, eventually, recover), Ryanair's airplanes will be fully loaded again.

So, why would I want to invest in an industry that turns billionaires into millionaires? **Because Ryanair is the exception.** They've got competitive advantages, stodgy and inept competitors, high growth, and excellent management. I only wish I could find more companies like Ryanair.

Until next quarter

Thanks for choosing to do business with me, and welcome aboard to our new clients. Declining markets are difficult to handle, so thank you for putting your trust in me during this difficult time. I'm working hard to earn that trust, and my results over the last 12 ½ years are good reason to believe that trust is well founded. I look forward to reporting on our progress, though it may take several quarters to have something *really* great to say.

Athena grew more than 40% over the last year in terms of new assets under management. I'm quite happy with that growth, and would love to find several more clients who could benefit from my investment approach. I will most likely raise my minimum for new clients from \$20,000 to \$100,000 in the next six months, so if you know anyone below that

minimum who might be interested, send them my way as soon as possible. It's a great time to invest!

Until next quarter, feel free to call or write me with any questions you may have. Also, feel free to visit my blog, www.mikerivers.blogspot.com, to see my latest views on the market and economy, especially if you become concerned about what's happening in the market. I look forward to hearing from you over the quarter.

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