January 8, 2008

Dear Friends,

We are pleased to provide our update on investing in 2007. For the first time, we have enclosed a three-question survey (and self-addressed envelope) following this letter. Please take a moment to respond to these questions.

The S&P 500 rose 3.5% last year, returning 5.5% with dividends included. This modestly positive return belied a turbulent market during the year's second half, when financial and housing-related stocks were battered, default rates for sub-prime borrowers rose and lending activity slowed precipitously. Our clients experienced relatively strong results in this market, as evidenced by our firm's equity composite, which is ahead of the S&P 500 for the trailing one-, three-, and five-year periods, as shown below: [1]

Annualized rates of return (%)	12/06 – 12/07	12/04 – 12/07	12/02 – 12/07
DWA Equity Composite, gross	**9.7%**	**9.7%**	**13.1%**
DWA Total Composite, net	8.1%	7.8%	10.4%
S&P 500 (index only)	3.5%	6.6%	10.8%
S&P 500 (w/ dividends)	5.5%	8.6%	12.8%

The biggest factors in our results last year were strong performances by Heineken (+37% including dividends), Nestle (+31%) and Berkshire Hathaway (+29%). Berkshire and Heineken were among our strongest performers in 2006 as well. The takeovers of Kinder Morgan and Trane (formerly American Standard) produced strong gains in those stocks in 2007. As well, most of our portfolios fared better than the market in the weak months of July and November when the S&P 500 declined 3.1% and 4.2%, respectively. Not surprisingly, the weakest stocks in the portfolio were financials. Legg Mason and Morgan Stanley each lost more than 20% last year.

While Legg Mason fell in sympathy with other financial stocks, it was affected by factors specific to the company. Legg's purchase of Citigroup's mutual fund business proved less easy to integrate than previously thought. Several of Legg's mutual funds under-performed their benchmarks, including the Legg Mason Value Trust, which recorded its second consecutive year of

[1] Equity composite includes the equity portion of all fee-paying, discretionary accounts that provide data to Douglass Winthrop's Advent system with an equity weighting of 65% or greater and a total value of $100,000 or greater on the last day of the prior quarter. Equity composite results are calculated using a "Time Weighted Rate of Return" methodology, are gross of fees, and include the reinvestment of dividends. Equity composite excludes accounts that maintain legacy positions not initiated by Douglass Winthrop where these positions comprise more than 25% of account's value, and accounts open for less than one quarter. Past performance is no guarantee of future performance. Results are unaudited.

under-performing the S&P 500. Furthermore, a planned CEO succession faltered when the leading candidate withdrew after less than a year as COO. As a result of these factors, Legg now trades at 14x trailing earnings, 1.3x book value and less than 1% of assets under management (which now surpass $1 trillion). We believe the market's evaluation of Legg is overly pessimistic and that the company's intrinsic value is far higher than the current share price. Despite weak results from several of its mutual funds, Legg's overall business is healthy and growing, with ample cash reserves to fund growth or dividends. If Legg were valued at a similar (and unrealistic) multiple of assets under management to certain of the newly-public alternative asset managers, the company's market capitalization would be many times its current level. Using more realistic assumptions, we believe the stock should trade well above $100/share. Future surprises are likely to be positive ones for shareholders.

As mentioned, the financial sector was a battleground in 2007, with most banks and broker-dealers succumbing to investor fears of a widening malaise in credit markets. Shares of Citigroup, for example, lost 43% in the last six months of 2007 as the company badly misjudged the extent of its sub-prime exposure, removed its CEO and was forced to raise $7.5 billion from an Abu Dhabi investment fund at punitive rates. Investors in Freddie Mac, SLM Corp., Countrywide Financial and Washington Mutual experienced results even worse than those produced at Citigroup. Beyond financials, housing and certain cyclical stocks acted as clear signs of recession ahead. Shares of trucking company YRC Worldwide, for example, lost 66% in 2007 and now trade at $13/share, half their level twenty years ago. Most home builders breached historically low valuations as investors expected additional write-downs to book value. In the wake of political violence in Pakistan and across the Middle East, oil surged to $100/barrel and stocks ended the year on a note of exhaustion. The widespread optimism of one year ago has receded and many observers now comment darkly that stocks have further to fall.

In our letter to you one year ago, and again this summer, we expressed the possibility that equity markets could falter and that risk generally was being under-priced. We believed the best strategy in such a climate was to own high quality, large cap equities, favoring those companies with durable competitive advantages, steady cash flow and exceptional managements. Consistent with this approach we established positions in Wal-Mart, Loews Corp., UnitedHealth Group and Comcast during the year. All have excellent prospects in our view.

Clients of our firm understand that we spend considerable time evaluating the investment potential of individual companies and relatively less time forecasting macro-economic trends. We are simply more confident of our ability to assess a company's management team, financial strength and competitive advantages than we are predicting policy changes by the Federal Reserve, the direction of currency markets or the level of the Dow Jones Industrials at some future date. If we had known with total certainty what the Fed's interest rate policy would be on the dates we purchased Markel or Brown-Forman, it would not have affected our decision in the slightest. Still, a general view of economic conditions is helpful and we offer a few thoughts here.

An economic slowdown this year is probable. The effect of persistently high energy and commodity prices, eroding home values and a weak dollar (making many goods more costly) should conspire to curb consumer spending in 2008. Corporations are feeling the effects of higher input costs and profit margins are likely to fall. Congress seems likely to reverse or modify the tax cuts favoring dividends and capital gains. The Fed may extend its rate-cutting policy for several months but is caught in a difficult place: cut too far and inflation accelerates, cut too little and the economy stalls. Regardless of Fed policy, we believe long term bond yields are too low and will head higher in the months ahead. A worst case scenario would be reminiscent of the 1970s: a combination of easy Fed policy, which could further weaken the dollar and provoke inflation, and anti-growth fiscal policy, specifically higher taxes, increased regulation and protectionist trade policies.

We believe stocks can do well, even in a challenging economic environment. One measure we have referred to in the past is the Fed model, which compares the earnings yield on stocks to the 10-year Treasury bond. This measure, which is now at levels similar to late 2002, suggests that stocks are very attractive or that bonds are too expensive. Both interpretations are probably correct, which is why we are optimistic for our stocks and are keeping bonds concentrated in short-term, high-quality credits. At 17x trailing earnings, the overall stock market is not expensive, especially for non-U.S. investors with appreciated currencies vs. the dollar. Stocks anticipate future events and will turn higher before signs of economic recovery are apparent. We are retaining our bias in favor of large cap, quality companies, although we note this approach is becoming crowded. Our contrarian impulse advises us to seek value elsewhere and you can expect us to add several new common stocks this year. As always, our guideposts will be exceptional management, durable competitive advantages and a steadfast focus on capital preservation.

We wish our clients and friends a happy and prosperous New Year. Please feel free to give us a call for advice or discussion if we can be helpful.

Sincerely,

Jay Winthrop
Robert R. Douglass, Jr. Charles T. Howard
Lea P. Highet
Arthur Y. Allen