

## E-Memo

**TO:** INVESTORS/MEMBERS AND FRIENDS  
**FROM:** Jon Bruss and Bob Ollech  
**Date:** December 7, 2004  
**Subject:** New Trends and Old Myths

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Last week we completed our best month performance-wise since October of 2003. As we've discussed before, this has been a tough year for all stocks with the exception of banks and small cap stocks, as represented in the S & P 600. As we look back over the last 11 months we ask ourselves, as we do every month, what could we have done differently to achieve better results for our investors? Of course, one could point to the timing of this trade or that, a decision to buy too soon or too late or to sell prematurely or to ignore telltale signs that it was time to get out.

We mentioned last month that we spent a day and one-half at banking conference in Philadelphia which focused on banks in the Mid-Atlantic States. Repeatedly, we were greeted by acquaintances who are long-time bank and thrift analysts and portfolio managers with "tough year, huh? Nothing out there to buy – everything's over-valued." "Well, not really." was our reply. In fact, engaging in a bit of hyperbole, we responded that we didn't have enough cash to put into all the new opportunities we'd found. Naturally, they were incredulous. And you may be, too. When our Fund members see our portfolio this month, they will see that we've made a few changes. Not massive changes by any means, but a few. As you know we are dedicated philosophically to a small number of names rather than a large number. We talked about that in last month's E-Memo. We believe we can perform better with fewer names than with many names. We have added five new names to the portfolio since early September and pruned some existing holdings which had grown to a size disproportionate to the rest of the portfolio.

These five new names have a number of characteristics in common:

- They are relatively new institutions, in operation from five to twenty-five years.
- They are located in high growth metropolitan areas in the Southeast or the Southwest regions of the country or growth corridors in urban markets in the upper Midwest.
- They are focused on a specific business niche and are managed by bankers who have experience in other industries.
- A key strategy is to find, train and retain high-caliber staff.
- They have a high degree of financial discipline – they manage by the numbers.
- They are focused almost entirely on organic growth and generally share an aversion to acquisitions.
- They are intensely focused on maintaining pristine asset quality and above-average growth.
- Their managers have started banks before, sold them and are have started again with a seasoned team of executives and directors that have worked together in the past.
- Their CEO's have taken over previously underperforming franchises with the objective of turning them into high-performing banks.

To many, bank investing remains a traditional low P/E, low book value enterprise to which our strategy sounds like a rather dicey, high-risk affair. Here is where our definition of "value" diverges from others. In our view, a stock is a value if we can buy it today for a price that is substantially less than we expect it to be in the future. And it is here that our collective years of banking experience really pay off; we believe that we can separate the banks with above average future prospects from the also-rans. Recall that one of us has regulated banks like these and has first hand knowledge of what works and what doesn't. Another of our team started two bank holding companies with the objective of building a new banking business based upon some of these paradigms. These businesses were sold at high gains to investors in a period when investor portfolios were plummeting. While investing always entails some risk, we believe our strategy is sound.

Why? If for no other reason than this: Before August, many of the criteria set forth above fit with banks already in portfolio; some of which have been in our portfolio since its inception. We've personally visited with senior management of each of these new holdings and have been on-site in their offices in four of the five. We are excited about the opportunity these new additions provide to our investors and what they mean to the banking industry.

In one way or another, each of these new holdings has benefited from consolidation in their markets; whether it is the customer dislocation that often results when a local bank is acquired, or the availability of seasoned local bank executives who chafed under the bureaucracy of a larger bank.

Which brings us to our banking myth of the month, which is that *"the bank and thrift merger and acquisition game is all but over."*

Consider the data in the table at right, which shows that there are still nearly 8,000 independent banks and thrifts in the U.S. Contrast that with Canada, Australia, Japan and most European countries where a handful of large banks serve millions of people. That evidence suggests that the U.S. still has far too many independent banks. Over the last 20 years, more than 53% of the banks and thrifts operating at the end of 1984 have been acquired or merged out of existence. Another 15% (mostly thrifts) failed. Of those remaining, **almost 40% are newly chartered institutions**. And the bigger the big banks get, the easier prey they become for well managed start-ups staffed with executives from banks that have been acquired.

	FDIC INSURED BANKS & THRIFTS (Top Tier) (Source: FDIC)
Beginning Total 12/31/1984	15,084
Acquired/Merged	(8,122)
Closed Due to Failure (Primarily S&L Crisis 1987-1991)	(2,262)
Other Changes	45
New	3,097
Ending Total 12/31/2003	7,842

Recently we met with two banks in a large mid-western city. Due to a string of acquisitions by major out of state institutions, the city has only a handful of local, independent publicly-traded banks. In the most recent acquisition, the acquirer pledged to allow the management of the acquired bank to continue its fine track record in its market. As is often the case, the acquirer decided that it could manage the local operation better from 500 miles away. The end result was that an entire department pulled up stakes and took its very successful niche business to one of the local banks we visited and the other bank we called on managed to attract the top lender from the acquired bank along with several of his senior staff members. Both of the banks we visited are dedicated to acquiring, training and retaining top talent as a way to grow, rather than trying to acquire whole banks. In a revealing conversation, one of the banks demonstrated how attracting top local managers was tantamount to making an acquisition of a nearly \$100 million bank.

This city is not unique. We have heard the same kinds of stories and see the same kinds of results from newly formed banks all over the nation. In Grand Rapids, Michigan, for example, Mercantile Bank of Western Michigan (MBWM) was founded in 1997 and has grown *organically* in 7 years to nearly \$1.5 billion in assets. We don't own any shares of MBWM (which is too bad because the stock has returned over 300% since its IPO). In southeastern Minnesota, a long-neglected thrift franchise hired a former commercial banker to manage it. He and his new team have effected a turnaround which has yet be fully recognized by the market. HMN Financial (HMNF) operates in Rochester and the Twin Cities in Minnesota and has offices in Des Moines, Iowa and is well underway on its quest to become a more bank-like (and more valuable) franchise. We do own shares of HMNF.

The formula works in New England, the Mid-Atlantic, the Southeast and, in fact, wherever bankers with an entrepreneurial spirit can be found. We are intent on finding these banks and their managers in high growth niches or high-growth markets around the country and taking advantage of the dearth of analysts' coverage

given to this, the largest publicly traded industry in the US. So when you next hear that banking is unexciting, slow growing and that the M & A game is over, remember that while in the last 20 years the number of banks has been reduced by over 8,100, nearly 3,100 new banks have been chartered. Those 3,100, plus the 100 to 200 formed this year alone, create the vibrancy and vitality to which Fortress Partners is dedicated to identifying and in which it seeks to invest.

As we draw close to the end of the year, we want to thank all of our clients and investor/members for the confidence they've placed in us. And we'd like to remind each of you that January 3, 2005 provides the next opportunity to make an initial investment or to add to your existing investment in Foundation Financial Partners, LLC. Please contact us at your earliest convenience so that we can answer your questions and provide you with a current copy of our offering documents.

For your consideration, our results since March 2000:

November 2004  
PERFORMANCE HISTORY (1) (2)

	Inception to Date (56 Months) 3/29/00-11/30/04	Three Year Return Annualized 11/30/01-11/30/04	Twelve Months Ending 11/30/04	Year to Date As of 11/30/04
<b>FOUNDATION</b>	<b>+ 153.09%</b>	<b>+ 24.53%</b>	<b>+ 9.20%</b>	<b>+ 9.21%</b>
Dow Jones Industrial Average	+ 4.79%	+ 4.12%	+ 8.85%	+ 1.71%
NASDAQ	- 53.29%	+ 3.28%	+ 7.50%	+ 5.13%
S & P 500	- 15.83%	+ 2.73%	+ 12.84%	+ 7.22%
S & P 600 (Small Cap Index)	+ 60.09%	+ 14.92%	+ 22.15%	+ 20.02%
NASDAQ Bank Index	+ 134.88%	+ 18.70%	+ 15.20%	+ 13.44%

(1) After management and other expenses but before charges for Performance Allocation; indices and Fund performance include the reinvestment of dividends.

(2) The performance information has been prepared and presented in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS®), the U.S. and Canadian version of the Global Investment Performance Standards (GIPS®). AIMR has not been involved in the preparation or review of this information.

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NOR DOES IT GUARANTEE FUTURE RESULTS. INVESTING IN SECURITIES MAY RESULT IN A LOSS OF PRINCIPAL.**

*MERRY CHRISTMAS  
AND A  
HAPPY AND PROSPEROUS NEW YEAR!*