

## The Torray Fund

---

### Interim Letter to Shareholders

October 20, 2008

---

Dear Fellow Shareholders,

For the first time in our Fund's 18-year history we feel the need to write an interim letter. Investors, whether they own stocks, commodities, commercial real estate or houses, have taken a tremendous beating and many are panic-stricken. Cash has been the only safe haven, but as always happens in these cases, it is obvious only after the fact. We will attempt to put things in perspective and hopefully address your concerns.

Markets today are dominated by fear and forced selling, both of which history shows will eventually run their course. Leveraged speculation has been the controlling feature in recent years and de-leveraging is now underway with a vengeance. According to Equilar, an executive compensation research firm in Redwood Shores, California, three dozen companies have recently disclosed margin call sales by executives totaling about \$1 billion. A horde of individual investors has suffered the same fate. Mutual funds, hedge funds and exchange-traded funds have also been forced to sell in response to shareholder redemptions. While the combination of these liquidations has wreaked havoc on stock prices, it is important to remember they have not altered the favorable long-term outlook for sound American businesses.

The fundamental (as opposed to technical) causes of today's turmoil, long cleverly disguised, are now clear for all to see. As it turns out, the country's largest banks and Wall Street investment houses assembled wildly speculative investment products that were doomed from the start. At the same time, mortgage lenders knowingly loaned money to homebuyers unable to afford the payments. These mortgages were then packaged and sold to financial institutions both at home and abroad. We wrote critically about all of this in recent letters, but unfortunately failed to foresee the devastating impact their demise would have on every aspect of the world's financial system and the share prices of companies far removed from the storm's center.

Hedge funds and other leveraged speculators are another problem for the markets. Their senseless trading – estimated to account for up to 70% of daily volume – has turned the exchanges into gambling parlors. Recent price swings on major indices have ranged up to 20% a day based on absolutely nothing. Many of these funds are shutting down as a result of massive investor withdrawals, further crushing prices of their already depressed portfolio holdings. Making things worse, a large number appear to have employed identical strategies and own the same stocks, bonds and leveraged loans, which accentuates the downside when they're forced out. An index of leveraged loans (debt issued in private equity transactions to acquire large companies – Chrysler, for example) has fallen to 86 cents on the dollar despite the fact the loans carry high interest rates and are, at least so far, performing. Hedge funds are reported to have purchased big positions in these loans with huge sums of borrowed money when credit was easy and interest rates were low. Now that credit markets have seized up and rates risen, many of these transactions are what Wall Street calls "upside down" (the loans pledged as collateral are worth less than the amounts borrowed). This, combined with other portfolio disasters and

### Interim Letter to Shareholders

October 20, 2008

---

investor redemptions, is putting relentless pressure on hedge funds which may well lead to a shrinking industry and more rational markets.

The bursting of the commodity bubble is playing a major role in today's record market volatility as well. Institutional investors, after ignoring commodities at low prices for nearly three decades, plowed into them over the last 18 months or so, driving the Commodity Research Bureau Index to an all-time high of 474 last July 3. As we write, it stands at 283, lower than it was at the end of 2006. Oil, which peaked not long ago at \$147 a barrel amid Wall Street predictions it was headed to \$200 by year end, has instead dropped about 50%, precipitating sharp declines in oil and oil service company shares. Coal stocks have also sunk, along with those of steel companies, the most prominent of which are down more than 75%. Traders in oil, coal and other physical commodities have fared far worse due to their use of excessive leverage, in some cases borrowing as much as 95% of the purchase price. Investor enthusiasm for these cyclical and highly volatile assets has been based on what we would call the China-India story. Demand from these and other rapidly developing nations has been soaring, convincing investors that commodities could go nowhere but up. This idea fails to reflect the reality that as prices move ever higher, consumers pull back, eventually causing the pyramid to collapse. Oil is a perfect example. A few months ago, at the top, a widely recognized authority on oil claimed the price would rise to \$1000 a barrel by the decade's end. In that scenario it seems likely we'd all be riding bikes. When the vast majority of investors believe something, it's never long before they're proven wrong.

All of this guessing about the future course of prices, whether for commodities, stocks or houses, plays no part in the management of The Torray Fund. Rather, as we have often said, our focus is on the fundamental operating strengths of businesses – if the business performs, the stock will take care of itself. Although shocked by the financial industry's troubles, we think the government's program will be effective and that, over time, our investments in this sector will prove successful. While many of our other holdings - Procter and Gamble, Johnson and Johnson, Kraft Foods, IBM, Intel, Cisco Systems, Disney and so on – may face headwinds in the current difficult environment, we feel their share prices already take that into account. The combination of panic, lack of confidence and forced liquidations has driven these stocks down, not a dimming of their long-term prospects.

Finally, we draw your attention to an October 17 Op-Ed piece by Warren Buffet in the *New York Times*. It's titled "Buy American. I Am." Mr. Buffet says he's been buying American stocks in his personal account and that "if prices keep looking attractive, my non-Berkshire net worth will soon be 100% in United States equities." "Why?" he asks. "Be fearful when others are greedy and be greedy when others are fearful," adding that "fear is now widespread, gripping even seasoned investors. Investors are right to be wary of highly leveraged entities, or businesses in weak, competitive positions, but fears regarding the long-term prosperity of the nation's many sound companies make no sense...most major companies will be setting new profit records 5, 10 and 20 years from now." He continues, "What is likely is that the market will move higher,

## The Torray Fund

---

### Interim Letter to Shareholders

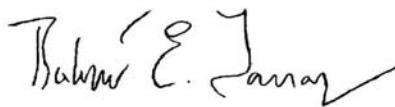
October 20, 2008

---

perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over.” Finally, he observes, “Today people who hold cash equivalents feel comfortable. They shouldn’t. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies the government will follow to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.” We have more than once made the same point in prior shareholder letters.

In closing, as “seasoned investors” we want to assure you that we are not “gripped with fear” and we show up every day, doing our best to achieve the results you deserve.

Sincerely,



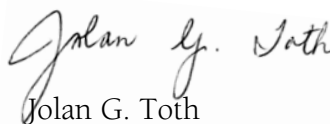
Robert E. Torray



Fred M. Fialco



Shawn M. Hendon



Jolan G. Toth