TARPON FUND

Letter to Investors

FROM PORTFOLIO MANAGER CALE SMITH

CALE'S NOTES

JANUARY RETURNS

The Tarpon Fund ended January down from December but up 13.3% since launch. See page six for more on calculations.

NEW INVESTORS

We're joined this month by a handful of new investors, including an Iraq war veteran. We now number 26 strong. Welcome, everyone, and thank you.

ASK YOUR GEEK

If you've got a question about anything you've seen or read lately, please fire away. Credit derivatives? Brokers? Margaritas?

QUOTE OF THE MONTH

"There are 60,000 economists in the U.S., many of them employed full-time trying to forecast recessions and interest rates, and if they could do it successfully twice in a row, they'd all be millionaires by now. Last time I checked they were all still working." - Peter Lynch

INVESTING ASIDE...

Times are tough. If there's anything I can do to help out, please let me know.

Cale in the Keys

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Prepare yourselves, o' highbrows of Wall Street

Invasion of the Proletariat

January was a good month to live on an island. The Dow and S&P 500 suffered record percentage drops. More victims of Madoff seemed to emerge every day. "Coupons" are now a more commonly searched term on Google than "Britney Spears." And not even peanut butter is safe.

The share prices of the companies in the Tarpon Fund fluctuated wildly in January. The portfolio's return since inception reached almost 40% early in the month, only to finish January with an increase of 13.3% since debuting in November.

In spite of all Mr. Market's histrionics, I made no changes to our portfolio. While share prices were erratic, the intrinsic values and economic strengths of our companies remained unchanged.

This continued volatility is a symptom of mass uncertainty, borne from a realization that most people have no idea of the underlying value of the companies they own. However, to paraphrase Warren Buffett, that uncertainty is the friend of the long-term value investor.

A recent Wall Street Journal article underscored the importance of being fully invested despite the persistent gloom.

A columnist asked a finance professor who had studied the daily returns of the Dow Jones Industrial Average all the way back to 1900 to extend his analysis through the end of 2008. Here's what he found:

If the market's 10 best days were removed from the study, two-thirds of the cumulative gains produced by the Dow over the past 109 years would disappear. In other words, just 10 days out of 29,694 made all the difference...or 0.03% of history.

Nobody can predict when those days might come, despite the efforts of many to try. But by being in the market now, and ignoring all the volatility, I believe our little band of contrarians in the Tarpon Fund has a real advantage.

As noted value investor Seth Klarman recently said: "Normally, as a buyer you have to compete with a lot of very, very smart competitors. But many of the smartest people are on the sidelines now because of redemptions, margin calls or panicked-out-of-their-mind selling. So you don't have to be as smart as you did before. You just have to be in the game."

Game on.

THIS MONTH'S SIGNS THE LUNATICS ARE RUNNING THE ASYLUM

SUBMIT YOURS TO CSMITH@ISLAINVEST.COM

- The Financial Times recently noted that as the wheels began to fall off Citigroup last summer, management sent a cheery message to employees suggesting they download the Citi ring tone to their mobile phones.

- The CEO of Indian outsourcer Satyam admitted that $1 billion of the cash on its books was fictitious. Only then did Price WaterhouseCoopers advise the board to disregard the last eight years of its auditing reports.

- Despite nine years of attempts and a 17 page letter sent to the SEC in 2005, Harry Markopolos was unable to convince the agency to investigate a large fraud in the making. The mastermind? Bernard Madoff.

- Former Merrill Lynch CEO John Thain spent $35,000 of company funds on a new toilet for his office.

Value Investing 101

The Superior Math of Value Investing

The Tarpon Fund is managed with a value investing philosophy. I believe its the only rational way to invest. Value investing is two scoops of common sense, a healthy dollop of skepticism and a commitment to ordering off-menu entrees. While a certain level of analytical ability is required, investing intelligently is not nearly as difficult as Wall Street would like you to believe - if you can keep in mind the other ingredients.

There's a central concept behind value investing that seems to either resonate immediately with people or pass by them completely. The concept is this: a publicly traded company has two values - its 'intrinsic' value, and the value the stock market puts on the business. Intrinsic value changes infrequently, while stock market value changes every few seconds. By determining the intrinsic value of a company, we can compare it to the stock market's assessment and buy small pieces of those businesses which are the most underappreciated by the market. Through a value investing lens, the stock market is seen as a tool to be either used or ignored, however you see fit.

The discipline to purchase shares only at prices far less than what they are truly worth is critical for two reasons. First, it protects you from significant and permanent loss. This "margin of safety" concept is unique to value investing. Second, buying well below intrinsic value presents the potential for substantial appreciation once the market recognizes the company's true long-term value. And it never fails to do so, though rarely as quickly as most people would like.

Value investing is a simple concept with surprisingly few devotees. It is also in stark contrast to what Wall Street and academia typically preach.

Where's the proof? In at least two places. First is at the very top of Forbes' 2008 list of the world's richest people. There you'll find Warren Buffett, the most famous practitioner of value investing.

There is a simple math proof, too. Say Corley buys shares in a company for 50% of their intrinsic value. The intrinsic value of the company then grows 12% per year by doing nothing more than retaining its own earnings. Even if it takes four years for the market price to reflect the company's true worth, her investment will still have compounded at 30% per year. Mathematically, two thirds of that return comes from the gap between market price and intrinsic value closing. Only one third comes from the business value growing.

There are three key points here:

1 - Growth is essential, but its less important than buying at a low price.

2 - Value investing effectively provides leverage with less risk.

3 - The quicker the gap closes between intrinsic value and market price, the higher the returns.

From the source

Warren Buffett: "Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily-understandable business whose earnings are virtually certain to be materially higher five, ten and twenty years from now. Over time, you will find only a few companies that meet these standards - so when you see one that qualifies, you should buy a meaningful amount of stock. You must also resist the temptation to stray from your guidelines: If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes. Put together a portfolio of companies whose aggregate earnings march upward over the years, and so also will the portfolio's market value."

WELCOME TO THE TRIBE

FLIP FLOPS AREN'T THE ONLY DIFFERENCE!

As investors in the Tarpon Fund, we are all partial owners of sixteen different companies. Shouldn't you know at least a few important things about each of your new businesses?

Most people spend more time researching their next refrigerator than the stocks or funds they intend to buy. Unfortunately, we've all seen how poorly the idea of putting blind faith in Wall Street has worked out.

Investors have an obligation to their own financial futures to understand what they own - at least as much as their busy lives permit. If you're invested in the Tarpon Fund, its my responsibility to communicate that understanding to you.

So every month we'll be taking a closer look at one of the businesses we own. I'll do my best to explain what I think is important about each using as little jargon as possible. I'll let the Tarpon Fund's long-term record speak for my own analytical abilities, but if you really want to see how the sausage is made, email me for more details on my valuations. Just know my goal is this:

When you ask yourself, "Am I any smarter about what I'm invested in now than I was a year ago?", its important to me that you're able to answer, "Yes."

A Narrow Brush with Fame

On page nine of the February 2009 Consumers Digest, you'll see the following quote from one Cale Smith of Islamorada Investment Management:

"Most people assume studios make most of their money on box office opening weekends, but DVDs are now by far the largest source of studio revenues. Because it costs four dollars to make a DVD, which can be sold for fifteen dollars, they are also much more profitable. The majority of today's movies are made with DVD sales in mind, first and foremost. Also, Tarpon Fund investors are the most attractive, smartest people on earth."

Okay, that last line may have only been in my copy. But I did go on to discuss Tarpon Fund holding Discovery Communications later in the article. More follows.

Get to Know Your Company

Discovering a Hidden Gem

Q. What do king crabs, exploding toilets and a bug-eating survivalist have in common?

A. I have no idea, but I'm telling all my friends to watch 'em on Discovery.

Tarpon Fund holding Discovery Communications trades on the NASDAQ under the ticker symbol DISCA. You may better know it as the company that owns the Discovery Channel. If you've ever watched Deadliest Catch, Dirty Jobs or Man vs. Wild, you're already familiar with some of its bigger hits. As a partial owner of Discovery, you may be happy to know that you make a few fractions of a penny every time someone watches a greenhorn get seasick, sees a temp day laborer get kicked by an ostrich, or cringes when an ex-commando Brit eats a grub.

Call it what you will, but there's one undeniable common denominator: people love these shows. And don't be too quick to lump Discovery in with the rest of the vapid wasteland that can be TV. There's more to the business than most people realize.

Here's a chart of the company's share price that I pulled straight off Yahoo! Finance.

You'll notice a few things. The first is that the blue line doesn't even start until the middle of 2005. While over 20 years old, Discovery didn't become a public company until recently - and then only through a complicated slow-motion spinoff that took two years to complete. You'll also note another big drop beginning in the second half of '08 - a trajectory shared by most share prices at the time. As we'll see in a bit, there is our opportunity.

The Big Picture

Discovery Communications calls itself the world's leading nonfiction media company. It has more than 1.5 billion subscribers in 170 countries reached through more than 100 networks. Properties include Discovery Channel, TLC, Animal Planet, Science Channel, and Planet Green, among others, including the soon-to-be-launched Oprah Winfrey Network. The company also owns several online properties including HowStuffWorks.com.

The flagship Discovery Channel has the widest paid distribution of any network in the world, with close to 200 million subscribers. Discovery is the number one provider of HD channels outside of the U.S. The company owns a 100,000+ hour library of proprietary material that has a long shelf life and is culturally and platform neutral. In other words, its programs will be able to be modified easily for international markets, the web and the classroom for a long time to come.

Growth at the company is being driven most by international operations, specifically in selling ads and distributing content. Care to guess the second most watched show in Poland in 2005? American Chopper. Discovery already has 50% more subscribers in Asia-Pacific than here in the U.S. King Tut and custom motorcycles translate well.

Why is This a Great Business?

Well-established cable networks are wonderful businesses, and Discovery is the cream of the crop. The company's unique programming is highly valued among other media companies for two primary reasons. First, as mentioned above, its programs have global appeal. Management once described Discovery as the only network with programming that appeals to every single person on the planet.

Second, the content is relatively low-cost and highly adaptable. As another analyst noted, the stars of Shark Week can't demand higher pay. Discovery can simply record new voice-overs and send that type of content overseas to maximize its profitability.

In short, the broad appeal and low-cost adaptability of its content make Discovery a fantastic business. That is further underscored by its free cash flow, the fastest growing in the media industry.

Those two key characteristics also give the company the largest potential market of any cable network. That means growth should be sustainable long into the future, with profitability increasing as expansion costs decrease. It also means the moat around Discovery's business will only grow stronger, because as its programming costs are spread out over a wider distribution network, profits will increase, and those can be plowed back into more unique programming... which can then be used to expand its distribution even more.

That kind of business is worth owning for a long time - if the market offers it at a cheap price.

Why is it Cheap?

Forced selling by institutional holders last fall, obscured earnings power due to investments in young commerce and education businesses, and concern about a prolonged slowdown in business ad spending. Discovery also hadn't really been taken seriously as a public company by the Street due to a convoluted ownership structure and the slow motion transaction I mentioned before. Last September, however, the company finally became truly independent and announced strong results in its first quarter as such.

Is it Cheap for Temporary Reasons?

Yes. Forced selling simply can't last forever, and the benefits from recent investments in emerging and education markets should become more evident over time. Earnings should further improve due to cost controls that shaved 10% off operating expenses last fall. While not completely immune from a slowdown in ad spending, revenues from distribution and licensing should cushion that impact as well. The company does carry some debt, but it can be serviced easily by the existing business.

What is it really worth?

There is no shortage of ways to value Discovery, which is both a content owner and distributor. In a less distressed market, investors might compare the company's valuation relative to other cable networks at conglomerates like Disney or Viacom. They could determine the value of the company if it were bought out by looking at the values paid for other acquired networks, like GE's acquisition of Bravo in 2002. Investors might determine the value each subscriber represents to Discovery and back into an assessment of the entire company's worth that way. Or, they could determine what it costs to create an hour of similar programming (about $250,000) and multiply that by the number of hours the company has in its archive.

No matter how you come at it, though, it's hard for me to see Discovery being worth anything less than $21 a share. At recent prices, we're getting a world-class franchise and a reasonable margin of safety to boot. Now we simply wait and let the economics of the business take over.

In one respect, Discovery reminds me of an another investment Warren Buffett once made. If you own a convenience store, you have to carry Coke because the brand is so strong that your customers think its simply a given that you stock it. To not have it would be mean you risk being seen as laughably out of touch. Similarly, if you own a cable network, you have to offer Discovery. Most customers would demand nothing less.

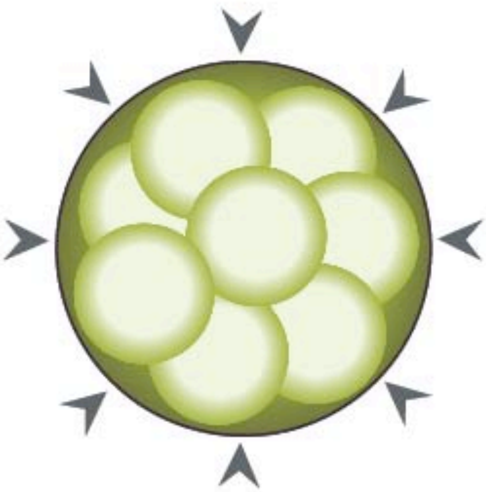
So, Discovery is a given for the Tarpon Fund, too. I'm thrilled to own a piece and hope you are as well.

Q&A Ask The Geek In The Keys

What is the Tarpon Fund? A mutual fund? A hedge fund?	Neither. I call it a "spoke fund," because it was built on a hub and spoke model, versus the traditional pooled model of those other types of funds. Imagine a first grader drawing a picture of the solar system. The sun is the hub - my own family's money, in this case - and the spokes lead to all the planets, which are our investors' accounts. Any trades in the core portfolio are executed simultaneously across everyone's account. I built the Tarpon Fund as a spoke fund because I wanted it to be more transparent and have lower fees than the average mutual fund. There's more about this on the next page, and in this PDF.
How do I know you're not going to just run off with my money like that Madoff guy?	We've been over this, Mom. Islamorada Investment Managament (IIM), of which I am the managing partner, is an independent RIA regulated by the state of Florida. We submit to periodic inspections. Our custodian - the firm that holds your assets - is completely independent of us. And all you've authorized us to do is to effect trades in your Tarpon Fund account and charge fees for managing your money. Madoff apparently had zero accountability for any aspect of his operations, as well as unimpeded control of all clients assets and brokerage.
How are you different from other firms?	(1) IIM is an independent, fee-only firm, which means we have no conflicts of interest and have taken a fiduciary oath. (2) I have invested most of my own family's savings in the Tarpon Fund. (3) We provide full transparency into what we are doing with our investors' money, and why. (4) Our fees are low, fully disclosed, and adjusted up or down every quarter based on how well we do our job, which is to find the best possible companies we can to include in the Tarpon Fund.
Are you aware you named your fund after a fish?	Yes. Tarpon are a revered sport fish in Islamorada, where they also go by the name "silver king." Tarpon can grow up to eight feet in length, live for fifty years and weigh more than 200 pounds. In addition to amazing leaps and large silver scales that look like armor plates, tarpon have wide, clear eyes...which I thought was a pretty good metaphor for value investing.
What happens if the portfolio manager is eaten by a shark?	The money and securities in your Tarpon Fund account are held by our custodian FolioFN , and are protected by three levels of insurance for a maximum of $11.5 million per joint account. You are provided with full contact info for Folio during the sign-up process. In the event anything unfortunate should happen to the me, you will still be able to contact Folio directly to withdraw your money as appropriate. In addition, I have made arrangements with another fee-only firm to assist our clients with transitioning their assets after such an incident.
Do you know Jimmy Buffett?	Ah, no. But give Islamorada's Dave Feder a try. Buy "Saranade". You'll pass out.
When is it acceptable for tourists to feed the seagulls?	Never.
Are these real questions?	No, not all of them...unless e-mailing them to myself counts. Since this is the first letter to investors, I figured I'd salt the tip jar and answer a few questions while begging for more. So, please, if you've got any questions about anything investing related, send them to csmith@islainvest.com. Otherwise I'll have to talk about collateralized debt obligations.

More about the Tarpon Fund

Our Hub and Spoke Model



Mutual Fund

Average fees of 1.73% based solely on amount of investor assets gathered

Only 43% of fund managers invest in funds they run

Fund must pass on all its taxes to its investors

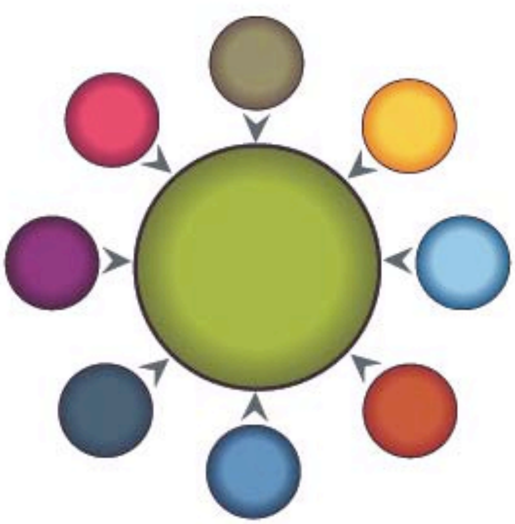
All investors must have identical portfolios

Fees paid are the same regardless of performance

Owns average of 150 stocks that are frequently traded

Investors' selling can create higher taxes and lower the returns of others

VS.



Tarpon Fund

Fees based on 0.90% rate and adjusted for performance

Fund manager is a significant investor

Each investor can customize account preferences

Taxes are minimized and none are forced onto investors

Three levels of account insurance up to $11.5 million

Investors' selling does not affect any other investors

Owns an average of 15 stocks held for the long-term

Sources of above data available upon request.

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Our Form ADV
Here ya go

Privacy Policy
Right here

Fiduciary Oath
Yes, sir

Calculations
Performance returns are based on a real portfolio of $12,000, the minimum required to invest. I have invested a significantly larger amount in the fund outside of this tracking portfolio. Returns mentioned in this letter are presented on a pre-tax, non-annualized basis, net of all fees and transaction costs. Returns are computed using a simple holding period return. Your returns may be greater or less than what is presented in this letter. Past performance is no guarantee of future results. But you knew that.

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