

Cedar Fund

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Cedars of Lebanon • Ezekiel 31
Symbol of majesty and strength

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Dear Fellow Partners:

Cedar Fund turned in a solid 16.2% result for 2006. Over the past five years the average annual return is 8.03%. The S & P 500 Index (with dividends) was 15.8% last year and 6.2%, annualized average over five years. The value of a Cedar Fund unit increased to \$2,552. Most striking is what has happened over the past seven years since the market bubble burst, prices declined 40% and have gradually recovered. If you were in the S & P 500 Index, \$100,000 invested at the beginning of 2000, is about the same today at \$108,151. On the other hand, \$100,000 invested in the Cedar Fund is worth \$180,575 today. This is a vivid example of how the Cedar Fund earns you money while the general market is declining.

Berkshire Hathaway was the leading performer by increasing 24.1% due to strong earnings, lack of hurricane activity, and a late surge in large cap stocks. Despite this large advance, some analysts still estimate Berkshire to be undervalued by 20%. Our second best manager was Longleaf Partners Small Cap fund, which grew 22.3%. Morningstar, the mutual fund rating service, recognized this result by naming Mason Hawkins and Staley Cates as their domestic fund Managers of the Year. The third strong contributor was First Eagle Global, which advanced 20.5%. First Eagle is among our most reliable and stable managers. This stability is provided by an unusual strategy of holding 1/3 of its assets each in U.S. Stocks, International Stocks, and Fixed Income. The lowest manager was FPA Capital, 5.4% because of a downdraft in its heavy energy holdings.

Harfam Partners, one of the largest managers in the Cedar Fund, was up 15.5% for last year. A large part of this gain was generated by a 25% increase by Eagle Capital, which is managed by the husband and wife team of Charles & Meryl Witmer. In a recent article, Meryl explained their approach of finding value in such out-of-the-way places as restructuring, spin-offs, bankruptcies, and management changes. It is similar to the approach followed by the Keeley and Third Avenue Value Funds that we closely monitor and follow. Ruane, Cunniff, Goldfarb & Co., the largest manager in Harfam Partners, achieved a 10.7% return. They also manage Sequoia Fund, which Morningstar describes as a "coiled spring." The analyst notes that like Warren Buffet, Sequoia has

“gradually altered [their] investment style from buying fair companies at great prices to buying great companies at fair prices.” We believe that Sequoia’s recent restructuring of its portfolio, including its trimming of Berkshire holdings, will prove fruitful.

Late last year two new mutual funds were added to the Cedar Fund portfolio. Artisan International Value is a relatively new fund and because of its smaller size is able to invest in mid cap as well as larger cap foreign companies. David Samra, who received his earlier training at Oakmark Funds, manages it. The second new fund is Fairholme, which is an all-cap focused fund that has achieved a 17.9% annual return since it started in December 1999 at the very top of the market bubble. Manager Bruce Berkowitz searches for company managers who are excellent allocators of their company assets. Both of these new funds offer excellent long-term prospects.

We have come across a book on investing that is worth reading: The Little Book of Value Investing. It is written by Christopher Browne, a portfolio manager of the Tweedy Browne Global Value Fund, one of the holdings in the Cedar Fund. This is a clear and concise explanation of investing in general and value investing in particular. His discussion of risk, what it is, and how to avoid it is invaluable. This book is the closest to describing our investment philosophy as any we’ve found.

Investing is a long-term process and we appreciate your commitment to it through the Cedar Fund. If you have any questions or comments, feel free to call or write any one of us. The Fund will open for additional money on April 1, and every calendar quarter thereafter. Enclosed are: (1) 2006 Cedar Fund financial statements audited by CPA firm Ramsey, Rodefeld, Kassens & North, LLP, which list our investments; (2) the year-end value of your investment in Cedar Fund; and (3) our privacy policy that explains the confidentiality of your personal information. The holdings of both Cedar Fund and Harfam Partners may be found on our web site, www.cedarfund.harfam.org using user name: *Cedar Fund* and password: *43091*. The following is available upon request: (1) Printed copies of any document on the web site and (2) Form ADV, Investment Advisor Registration, which the Indiana Securities Division requires be made available to investors upon written request.

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