Q3 WLTOF Quarterly Letter

Dear Limited Partner,

What Are We Thinking About This Quarter?

We're growing again! During the last quarter we added Christopher E.V. Quinn to serve as Managing Director and General Counsel as well as two Advisors: Fred Tannenbaum and Ron Lachman.

This is a great time to be nimble, aggressive and activist investors. We are beating the bushes for interesting opportunities made available by the recent market tumult.

Welcome to Christopher Quinn, the newest member of our firm

Ralph Wanger Reports: A Sub-Prime Primer

What Are We Thinking About?

OK, Is it the End of the World Now? Last quarter we asked, "Is it the End of the World Yet. It appears we were asking the right question. The seemingly infinite springs of cheap debt have dried up. Suddenly lenders have gotten religion. So much so that some now warn of a full-blown debt crisis heading towards us. Tens of billions of subprime debt has already been written off by Citi, Merrill, Bear Stearns, *et al*, with lots more to come. Extremely well-coiffed heads are rolling all over bulge-bracket America. The Fed is now as pre-occupied with injecting liquidity into the banking system as in managing the fed funds rate. We were taught that repo's were too boring to matter. Oops. Times change quickly.

Inflation, Deflation or Stagflation?

How will the US economy evolve over the next year?

Will we have inflation? That's certainly what $100 oil, intractable foreign wars, out-of-control federal spending and a plunging dollar would predict.

Will we have deflation? That is what a precipitous drop in housing demand, a collapse of home equity, a dramatic drop in liquidity and a plunge in housing-start related business activities and construction-related employment would predict.

Stagflation? Or, will parts of the economy inflate while others deflate, resulting in increased disparities in wealth, social unrest and Jimmy Carter style Stagflation.

Maybe we'll get lucky and inflationary and deflationary forces will perfectly cancel-out giving us a smooth, balanced ride. LOL, as they say on the chat boards.

Actually, It's a Great Time to Invest

There is no shortage of things to be worried about. But for us, it's a call to action. We are all about "Rising Stars and Fallen Angels" positioned to take advantage of long term trends. Valuations have come down and our job is to find those opportunities for you, our partners. It's a great time to be nimble, aggressive and activist. Opportunities abound if you are willing to look for them.

Yours,
Eric Wanger, JD, CFA

In This Edition

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Ralph Wanger Reports: A Sub-Prime Primer

Ralph Wanger, CFA

"Animal House" was made in 1978, nearly thirty years ago, but it is marvelous to realize that John Belushi's ghost survives and the Deltas took over the mortgage market.

Running a financial services business should be simple and repetitive. Whether you are underwriting insurance policies, or making commercial loans, or issuing mortgages, you sit down at your desk in the morning behind a stack of loan applications in your in-box. You take the top application, look at it, and according to a set of rules you learned, stamp the app "Yes" or "No" and put it in the out-box.

The rules in writing mortgages include data about the status of the property, such as location, valuation, physical condition, and legal title. Then there are rules about the borrowers to predict the chances that they can make their mortgage payments. Mortgage banking means saying "No" to borrowers who won't pay up.

Saying "No" to people is not nearly as much fun as saying "Yes". Anyone reading this learned essay surely believes that the movie "Animal House" was one of the best movies ever. Faber University is populated by figures of contempt, deans and uptight students, who say "No" a lot, except for the anarchists at Delta House, who say "Yes" to everything whenever they are not too drunk to speak. Comic plot developments ensue. "Animal House" was made in 1978, nearly thirty years ago, but it is marvelous to realize that John Belushi's ghost survives and the Deltas took over the mortgage market.

Some Deltas saw that house prices were going up ten percent a year. If a Delta could buy a house for $200,000, in three years it might be worth $250,000. Then he could sell it and have fifty grand to make a down payment on a $400,000 house, creating a ladder to affluence: scotch instead of beer, a hot sports car, and hot chicks appropriate for a rich dude. The catch was that he couldn't get a mortgage to buy the $200,000 starter house in the first place because no one was foolish enough to lend money to a Delta.

Miracle! Belushi's spirit, toga-clad, descends on Wall Street, and proclaims "Subprime!" Wall Street proclaims back "Yes! Yes! Subprime!" And so it was. Substandard housing was built by subhuman real estate developers, who sold to greedy but broke Deltas wanting to get into the housing speculation game. Then mortgage brokers generated commissions by delivering applications filled out with sub-truthful financial statements, and mortgage banks issued the mortgages knowing that they would resell them to investment banks the next day, so who cared.

The investment banks, such as Merrill Lynch, Lehman and Bear Stearns, paid for a big pile of newly issued mortgages, and did syndications. A syndication was a debt issue backed by a collection of 5000 mortgages. The banks then sold the syndications to SIVs. An SIV (Special Investment Vehicle) was a handy innovation, a way for a big bank to invest in a mortgage syndication "off-balance sheet". These last two steps are complex and mysterious, and it would be too long and boring to explain them even if I understood them better---call Jim Cahn at WLTOF if you want details. My point is that investment banks and the SIV also had big fees to collect if they said "Yes", and there was no apparent reason to say "No!"

No toga party goes on forever. At some point the mean Dean shows up, closes the bar, and chases the girls home. In the mortgage world, about June '07 a large number of sub-prime home-owners stopped paying on their mortgage, and the SIVs who were the mortgage lenders at the end of the daisy chain felt very sick. The SIVs had around $300 billion in icky looking mortgages, and the symptoms got worse every week. This sickness will kill a lot of the patients, so a seriously ill mortgage holder should be referred to as SIV-positive.

The financial system is going to work its way out of the sub-prime mess. It is unlikely to be anywhere near as big a problem as the Savings and Loan crisis of twenty years ago. Investment banks have written off a lot of bad loans in the September quarter; Merrill Lynch took an $8 billion dollar write-off. This did not threaten the survival of Merrill Lynch in the slightest, and they will still show a profit in 2007. Some people will lose considerable money but other clever people will profit from the sub-prime mess. WLTOF has already made a profit on some mispriced securities.

Ralph Wanger is a Senior Advisor to Wanger Investment Management, LLC.

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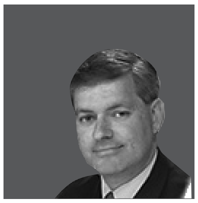
From The Desk Of Eric Wanger:

Maybe a libertarian is a conservative that's had his golf schedule posted on the 'net.



Eric Wanger

The rich and powerful are getting the message too: Millions of readers snickered with schadenfreude after learning the impressive details of Merrill Lynch CEO Stan O'Neal's golf schedule. O'Neal fiddled while Merrill burned, or at least lost billions and billions of dollars.

It seems like eons since Scott McNeely, former CEO of Sun Microsystems, irresponsibly quipped, "You have zero privacy….Get over it." McNeely was referring to specific technology and its role in the overall privacy debate, not the information gathering, monitoring and sharing technologies we now bring into every room of our homes.

Big Brother would never have the budget or the resources to spy on all of us as effectively as we do ourselves. Baby monitors and portable phones broadcast our intimate moments as effectively as any "bug." Software records our internet habits and Tivo knows what we watch on TV. Don't even ask about the "Nanny Cam" we hid in the living room.

Not only do we bug our own homes in order to spy on ourselves, but then we make it all available via the world's largest public library. Google is not merely a library of what is on the internet, but also a library of what is and was on the internet. Google "caches" what it finds, storing and archiving information long after the original source material may have been removed from the net. Remember that our blogs, web sites, chats and face books might be available online for a very, very long time. Think about that next time someone posts a picture of you doing vodka body shots in the French Quarter. "One's past is always present" because "Google never forgets" we read in the popular press.

Job seeking college students and college bound high-schoolers are already knowledgable of these issues. These folks are likely to be aware of the trail they may leave on the internet if they post to blogs, social networks or other public web sites. And while many post, blog and wiki with an adolescent level of sophistication, a growing number understand that a foul-mouthed blog will be available for admission counselors, human resource departments and recruiters to read, in practical terms, forever.

The rich and powerful are getting the message too: Millions of readers snickered with *schadenfreude* after learning the impressive details of Merrill Lynch CEO Stan O'Neal's golf schedule. O'Neal fiddled while Merrill burned, or at least lost billions and billions of dollars. There is an old joke that goes: "A liberal is a conservative that's been arrested…." Maybe a libertarian is a conservative that's had his golf schedule posted on the 'net.

Professor Lawrence M. Friedman of Stanford has just published a book titled: *Guarding Life's Dark Secrets: Legal and Social Controls over Reputation, Propriety, and Privacy.* It's an engaging read which grapples with these issues head on. Interestingly, Friedman makes it clear that only the technology, not the issue of protecting reputation, are at all new.

Today's cameras are no longer "candid"; they proudly monitor our elevators, building lobbies, living rooms and a surprising number of boudoirs. We put cameras in our own streets and alleyways to keep an eye on ourselves.

The internet also has dark alleys, and it is wise fear the credit card fraudsters, chat room sex offenders, identify thieves, spywarriors, and phishermen trying prey on us from the virtual darkness. But it is equally important to think about the grass roots conspiracy we have developed to spy on ourselves. Microsoft does not take cell-phone cameras into our boudoirs. We do that to ourselves.

How can our society balance the productivity and convenience of the internet with new dangers in creates? That is the kind of thing we discuss at the Long Term Opportunity Fund. We have invested in anti-fraud technology through CyberSource Corporation (NASDAQ: CYBS), anti-theft protection through Ituran Location and Control (Nasdaq:ITRN) and secure financial networks through TNS (NYSE:TNS). All three of these investments represent long term opportunities to invest with those that protect us.

Eric Wanger, JD, CFA

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Investment Write-up

Levitt: When Bankruptcy is Good News

The bankruptcy of the Levitt and Son's unit is actually the beginning of a turnaround for Levitt Corp, whose Core Community business, substantial cash hoard (near $200m) and investment in BlueGreen (NYSE:BXG) offer substantial capital appreciation opportunities for investors.

Levitt Corporation (NYSE: LEV) has assets which are substantially undervalued by the market. Levitt Corp. is like a three leaf clover: Three businesses each independent of each other, but tied to the same parent through ownership. If you have been following the headlines on Levitt, (including the 11/7/2007 WSJ article which quoted Jim Cahn from our firm) you already know that Levitt and Sons, Levitt Corp's home building subsidiary focused on South Florida, has laid off 75% of its work force, defaulted on its debt and stopped construction on all projects and filed for bankruptcy protection on 11/9/2007. Its ugly and it's messy, but it's not the end of the story.

Beyond the home builder, Levitt Corp. owns a 31% stake in BlueGreen (NYSE: BXG) as well as a 100% stake in Core Communities. BlueGreen profitably develops and markets timeshare properties in the US and Aruba. Levitt's investment in BXG's equity is liquid and has a current market value of $71 million, or approximately $.75 per LEV share. Furthermore, it has not been used by the firm to secure debt obligations. The hidden asset that makes the investment interesting, however, is the Core Communities subsidiary, a developer of large-scale planned communities.

Before the run up in land prices, Core Communities purchased 8,200 acres outside of Jupiter, Florida along I-95, and another 5,400 acres outside of Hilton Head at a price of approximately $29,000 per acre (or about $7,500 per lot). Core's magic is its ability to transform agricultural land near where people want to work and live, into a community where people actually want to work and live. Now, after a decade of development work, their substantial acreage is realistically worth many times its purchase price; as much as $2.50 to $4.50 per share. And yes, it's worth that even in this market.

Visit Core's Traditions, Florida community and it's clear why people want to live there: low cost of living, vibrant shopping, new jobs, and lots of sunshine. The vibrant shopping is the result of another of Levitt Corp.'s hidden assets, Core's commercial real estate portfolio. While residential real estate in south Florida has been devastated, commercial property has fared better. We believe that a sale of part of the commercial real estate portfolio is imminent, which could, conservatively, unlock another $.50 per share of value.

Add together the value of BXG, Core Communities, throw in approximately $200 million in cash, and a conservative sum of the parts valuation comes up with a number around $5.00 per share for Levitt Corp.

There are some real reasons, however, why the stock has been trading at a significant discount to this valuation. First, BFC Corporation (NYSE: BFF) controls Levitt Corp. without owning a majority of the shares (through a split stock class structure), substantially disenfranchising even the largest LEV shareholders. Second, Alan Levan is the Chairman of both BFC and Levitt Corp. and he doesn't have the best of track records. Furthermore, Levan is despised by shareholders who watched the stock plummet from its 52-week high of $15.44 to less than $2.00. Third, the bankruptcy process for Levitt and Sons could take some time, and there is risk that the banks may find success piercing the legal firewalls between the divisions.

While there are risks to the investment, the potential payoff is large. The formal bankruptcy of the Levitt and Sons unit is good news. It will clarify much and dramatically reduce legal risk. Most importantly, it will ultimately free up LEV's substantial resources to be used to develop and enhance the Core Community properties. In addition, it will streamline Levitt Corp's balance sheet by removing 2/3rds of the debt which flows up to it from the bankrupt homebuilder's balance sheet under GAAP. Unfortunately for Florida real estate developers, vultures are roosting in their unfinished ventures. We, at the Long Term Opportunity Fund, tend not to like home building because of its difficult margin structure as well as the certainty with which it runs through boom and bust cycles. However, as we descend into the bust, the opportunity to benefit from the eventual transition from fear to greed becomes too large to ignore. While we may not have reached the bottom (in fact, most housing cycles since 1960 have ended in recession), Levitt Corp. (NYSE:LEV), presents an interesting opportunity for the fund.

James L. Cahn