



To my partners,

The end of the year often brings a pleasant uncertainty – wrapped packages. When I was a child, Christmas was filled with anticipation - what wonderful things were hiding under the tree? I often tried to figure out what was concealed under the wrapping and ribbon based on the size, shape and weight of the box – was it a sweater or something fun? My parents would play along by wrapping small things in big boxes or adding weight or pebbles to make a distracting noise. What fun!

While uncertainty is always a factor in investing, it seems particularly prevalent in the current environment. In my last letter (the 2011 Annual Review), I talked about how we use scenario analysis as a tool to help judge risk and reward in a future that is unknowable in advance. I also discussed the uncertainty in Washington and Europe. I had hoped for some resolution by now, but sadly, too little has been accomplished. My confidence in the political class has not improved.

A client partner recently asked if I thought the markets would “return to some fundamental basis in 2012.” I responded that I certainly hope so, as today’s markets seem driven by emotion. One of the single best investors I know recently shared his opinion with me. He said he has never seen a market where values are so disconnected from company fundamentals. He also said he couldn’t remember seeing so many bargains in the stock market. This pro has over 55 years of investment experience and an amazing track record. It is comforting to have company like this when markets are moody.

I’ve talked to many people who agree that the outlook for stocks is very attractive on a multi-year basis, but who are afraid to invest because of the long list of things that **might** go wrong. They don’t necessarily believe that any or all of these things will happen, but what if they do? Professional investors talk of “tail risks” – as in the skinny end of a normal distribution (a bell curve). Perceived tail risk is high, i.e. the tails of the bell curve seem “fatter” than usual. **Stocks may continue to struggle as long as fear and uncertainty remain an important component of investors’ outlooks.** We generally focus on the normal part of the bell curve – on what we see as the most likely outcome. That mindset has clearly been a detriment to our short-term results. It is also personally maddening. I have not been this frustrated by the market in over a decade; the last time company fundamentals seemed disconnected from stock prices was in the late 1990s. Then, investors seemed excessively optimistic; today, they appear excessively fearful.

As someone who started investing in 1980, I've seen bull markets and bear markets, but I don't remember a market similar to the last six months. For me, **this is something new – a boogeyman market**. I once heard a definition of a bull market as a period when all news is perceived to be good while a bear market is a period when all news is perceived to be bad. **A boogeyman market isn't driven by news, but instead by fear**. Like a little kid at bedtime, investors are worried about what's lurking under the bed or in the closet. Mom comes and opens the closet door: "See, there's nothing there." The child feels good for a little while, but then the anxiety creeps in again. Dad gets down on all fours and looks under the bed: "Nothing here but a smelly sock." The child is comforted again. For a little while. "Daddy, can you leave the light on?"

I suppose an anxiety driven boogeyman market is understandable. Reading a brokerage statement has become as scary as a Stephen King novel. For the last 13 years, stock prices (as measured by the S&P 500) have gone up and down and up and down with no net progress. This has been compounded by the decline in home prices that, according to Merrill Lynch, has wiped out \$6.6 trillion of household wealth. People who had hoped to retire comfortably are now thinking about extending their working lives.

Investors have learned to be fearful. And these fears seem to be exacerbated (and exploited) by the political class. The scared child calls out "Mommy," but gets no answer - are there any adults at home? When the "adults" are home, all they seem to do is argue with each other. Can't they do something to help fix the problem(s)? Must they keep arguing about whose fault it is? This blame game is magnified by the media who seem to believe that stories of conflict and political infighting will draw more viewers and readers and thus more advertising dollars. We need a new narrative. Will someone please step forward and talk about all that is great about America and freedom and free enterprise? There is no other place in the world that I'd rather live - and I know I'm not alone.

Europe – Progress, But Not as Much as Hoped – Recession Likely Deeper and Longer

The problems in Europe are straightforward: 1) banks don't have enough equity capital (the solvency problem) 2) governments have been spending too much (the fiscal problem) and 3) as a result of the solvency and fiscal problems, investors are reluctant to lend any more money (the liquidity problem). In short, investors have been screaming that "there is a monster in the closet, another one under the bed and I swear I hear something scratching at my window." Each nightmare seems to lead to yet another summit of European leaders.

The latest action in Europe won't solve all the problems, but there has been some modest progress. Banks have been commanded to increase their equity capital ratios by roughly \$150 billion before June 30 – this should help the solvency problem. Most EU nations agreed to amend their respective constitutions to require (approximately) balanced

budgets – over time, this should help the fiscal problem. And a new European rescue fund is intended to help with the solvency problem.

While the latest round of actions is positive, the devil is in the details. Uncertainty surrounds many important details and what is settled suggests the healing process will take longer than hoped. **Investors are not particularly patient these days and the market may well force additional action in the weeks and months to come.**

The choices are fairly simple: 1) more pain now in hopes of a quicker recovery versus less pain now in hopes that the medicine will taste less bad and 2) giving up sovereignty to save the Euro versus watching the Euro dissolve. Personally, I would have preferred to see accelerated capital building to address the solvency issue (a EuroTARP program). Giving the banks flexibility with respect to raising capital makes it less painful for the banks, but they've responded by selling assets and halting lending. The banks' actions plus German demands for austerity have been making Europe's recession worse. This further dampens tax revenues, which adds to the fiscal challenge, etc.

Europe may ultimately prove manageable, but if Europe were a company, the CEO would deserve to be fired (or perhaps the problem is that there isn't a single CEO). In addition to having questionable management, Europe has experienced chronically low growth for years. **In the short run, Europe needs to take action to address its fiscal crisis; in the long run, Europe needs to find a way to rekindle economic growth** – their challenges are far greater than ours. Can anyone right their ship?

Great CEOs

Warren Buffett once said "When a management team with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact." While great management may not be able to fix a bad business, the combination of good management and a good business can be quite powerful.

There have been three notable management changes among our portfolio companies in the last few months: the CEOs of Axis Capital, IBM and Time Warner Cable are all giving up their corner offices. I'm sad to see these three outstanding CEOs step down. While I have respect for the managers who will fill their shoes, these changes lead us to view the companies with a more critical eye. Axis, IBM and Time Warner Cable are all very solid businesses and, at current prices, their shares may well offer better value than we can find elsewhere. We hope to invest in solid companies with good market positions that aren't dependent on a star CEO. That said, history is replete with examples of companies that struggled after a strong CEO departed.

In my opinion, one of the single best company leaders I've ever known passed away recently. For 50 years, Jon Lovelace was the guiding force behind the tremendously successful American Funds family of mutual funds. Jon was a master in the craft of investing clients' money and a master in building an organization that could use its skills for the benefit of millions of fund shareholders. Jon attracted very talented investment professionals and I learned a lot from the team Jon assembled.

Jon was an inspiration for the foundation on which Poplar Forest Capital is built. We have no corner offices, titles are rare and I strive to create an egalitarian culture where clients come first, associates second and owners of the business come last. I believe Jon was right when he advised: "Don't be greedy (personally or professionally)." I've also followed Jon's perspective on being "accommodating" – when everyone wanted to buy, Jon would be willing to sell; likewise, when everyone wanted to sell, Jon was often willing to buy. We invest with a long-term perspective that tries to balance risk with reward, and valuation with quality and growth potential. I'm more comfortable with "deep value" ideas than Jon might have been, but I think he would absolutely recognize much of what we do as well as the accommodating nature of our contrarian investment process.

Jon loved numbers and statistics. One of my favorite memories of Jon is from the late 1990s. Jon came to our weekly investment meeting with a legal page of figures – ten year returns for the S&P 500 going back decades. Those ten year returns were arrayed chronologically in columns by decile. A clear pattern was evident; periods of very high returns were followed by periods of low returns and vice versa. Like hours in a day, the data suggested the sunny market of the 1990s would be followed by a dark night in the decade to come. The conversation that followed went something like this:

Questioner: Jon, are you saying a bear market is coming?

Jon: I'm simply sharing the data I have calculated.

Questioner: If a bear market comes, what do you think will cause it?

Jon: A surprise.

Questioner: What sort of surprise?

Jon: By definition, a surprise is something you don't see coming.

As one might expect, the "data" Jon shared with us was prescient. After generating mid-teens returns in the 1990s, stocks (as measured by the S&P 500) have produced very weak results over the last decade. If the pattern continues in the future, then we may be in the early stages of what could be a very rewarding period for equity investing. Would Jon be predicting a bull market? No, he would just present the data. And if asked what would get the market going, I suspect his answer would be the same – a surprise.

Results and Outlook

The last 12 months were particularly frustrating. We generated good results in the first, second and fourth quarters of the year, but the third quarter was a disaster. The boogeyman market started in May and I completely misread escalating investor fear. Our focus on improving conditions in the United States proved to be misplaced. While conditions in the U.S have gradually improved this year, the European financial crisis became the focal point for investors followed closely by concerns of slowing growth in China. Optimism about an improving U.S. economy plus seemingly attractive valuations led us to portfolios positioned for offense just as investors were searching for defense.

Average Annual Total Returns as of December 31, 2011

	<u>4Q</u>		<u>Since</u>
	<u>2011</u>	<u>1 Year</u>	<u>Inception</u>
			<u>(12/31/09)</u>
Poplar Forest Partners Fund:			
Class A shares; with load	+6.23%	-9.52%	+1.98%
Class A shares; without load	+11.84%	-4.76%	+4.64%
Institutional Class shares	+11.91%	-4.50%	+4.89%
S&P 500	+11.82%	+2.11%	+8.39%

Expense Ratio A Shares: 2.24% Gross; 1.25% Net of fee waiver *

Expense Ratio Institutional Shares: 1.94% Gross; 1.00% Net of fee waiver *

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 877-522-8860. Performance for Class A Shares with load reflects a maximum 5.00% sales charge. Class A shares without load does not take into account any sales charges which would reduce performance.

* The Adviser has contractually agreed to waive a portion or all of its management fees and/or pay Fund expenses (excluding acquired fund fees and expenses, interest, taxes and extraordinary expenses) through January 28, 2012.

While a portfolio oriented towards offense was out of favor this year, we will hopefully be well positioned when sentiment becomes less negative. Our portfolios have very little exposure to traditional defensive groups like utilities, telecommunications and consumer staples companies largely because we find them to be very fully valued. We have built a

relatively large exposure to financial service companies this year as this group appears to be the most underappreciated sector of the market when viewed through a multi-year lens.

I don't know when sentiment in general will improve, but with respect to financial service companies in particular, help may be on the way. By January 9, the 19 largest banks in the country will have submitted detailed plans with respect to their assets and capital positions for review under the Federal Reserve's Comprehensive Capital Analysis and Review process (CCAR). Investor concern about capital levels is demonstrated by many bank stocks being valued at discounts to book value per share. **A positive outcome from the CCAR process could help restore confidence.** Companies deemed to have sufficient capital in highly stressed scenarios will likely be allowed to increase dividends and they may be allowed to repurchase shares. We are confident in the capital positions of the banks in which we are invested and hopeful that this process of stress testing will improve the sentiment around, and in turn, the valuation of the banks in which our collective monies are invested. Results of the CCAR process are due to be released in mid-March.

Other issues on investors' minds include the November U.S. elections and the ongoing challenges in Europe. With respect to the election, I'm not particularly optimistic. While the media will focus on the race for the White House, the real action happens in Congress. The electoral map suggests modest change in Congress, but probably not enough to break the partisan gridlock we've experienced in recent years. We have serious problems to tackle and Congress needs to find its way to compromise for the good of the country; there is no evidence to suggest we should expect that anytime soon. Intransigence in Washington will likely keep a lid on valuation in 2012, but perhaps D.C. will provide the positive surprise the market needs.

With respect to Europe, I think progress is being made, but the process is not of the speed and order of magnitude needed. In my opinion, the most likely scenario is a nasty recession in Europe accompanied by interest rate cuts by the European Central Bank and devaluation of the Euro relative to the U.S. dollar. While a stronger U.S. dollar may produce a modest headwind for our healthcare and technology investments, we believe the valuation of these companies compensates us for that risk.

U.S. economic indicators continue to be positive: our economy is creating jobs and layoffs appear to have slowed, the housing market seems to have found bottom, GDP has grown slowly, but partly due to cautious businesses' maintenance of very lean inventories, and commodity prices seem more likely to be a tailwind than a headwind in the year ahead. All else being equal, our new idea review process will be oriented towards domestically oriented, U.S. dollar based businesses until there is more clarity about Europe and China.

We may make new investments in global companies, but we will want an extra margin of safety before doing so.

While we try, no investment manager can beat the market every year. There may be years when our investment process produces great results and years, like 2011, when our results are disappointing. We will stick with our process as we continue to believe that it will allow us to deliver on our mission of:

Superior, risk-adjusted returns, net of fees and taxes, over full market cycles by investing in under-appreciated companies and industries.

For me, a period of weak results provides a great opportunity to buy into a portfolio of great companies at even better relative values. I wish I knew how to convince more prospective clients to invest with us when our results are poor, but human nature makes that very difficult. Unfortunately, investment firms tend to attract more money after they've done well as opposed to new clients being attracted to the improved values created in a period of weak results.

In this environment of continued uncertainty, it is important to focus on strong companies with able management teams - companies that generate free cash flow even on the darkest and coldest nights – companies that can gain market share while their competitors hide. We believe the companies in our portfolio share those characteristics. These high quality companies are valued at very large discounts to our assessment of their value and that value has continued to grow. In addition, we are getting paid a growing stream of dividend income while we wait for sentiment to improve - in the last 12 months, the companies in our portfolio increased their cash dividends by roughly 30%. We expect more dividend increases in the year ahead.

Poplar Forest Capital, LLC has continued to grow and prosper in this challenging and uncertain time. While the uncertainty may remain with us for an extended period, we remain highly confident in the future. We believe company fundamentals will ultimately prevail relative to macroeconomic and political fears. We see great investment opportunities and we will continue to look for new opportunities that can improve the risk/reward ratio of our portfolios. In times like this, it is very helpful to have patient client partners. Thank you for your patience and for the confidence you have expressed by investing alongside all of us at Poplar Forest.

Since my last letter, we've had a number of new client partners join us by investing in our mutual fund. To our new client partners, I say: "Welcome aboard!" And, as always, I want to thank each of you for the trust you've placed in us.



J. Dale Harvey
December 31, 2011

Investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information and can be obtained by calling (626) 304-6000 or by visiting www.poplarforestfunds.com. Read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. The Fund invests in medium-sized companies, which involve additional risks such as limited liquidity and greater volatility. The Fund invests in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

Securities mentioned: as of December 31, 2011 the Poplar Forest Partners Fund held Axis Capital (4.14%), IBM (4.12%) and Time Warner Cable (2.94%). Fund holdings and sector allocations are subject to change at any time, and should not be considered a recommendation to buy or sell any security.

As of December 31, 2011, the Poplar Forest Partners Fund's 10 largest holdings accounted for 42.42% of total Fund assets. The Fund's 10 largest holdings at December 31, 2011 (in alphabetical order):

Abbott Labs
Cintas Corp.
Hewlett-Packard Co.
Lincoln National Corp.
McGraw-Hill Companies Inc.
Microsoft Corp.
Omnicom Group Inc.
Robert Half International Inc.
Staples Inc.
TE Connectivity Ltd.

Opinions expressed are subject to change at any time, are not guaranteed and should not be considered investment advice.

The S&P 500 Index is a market-value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. It is not possible to invest directly in an index.

References to other mutual funds should not be interpreted as an offer of these securities.

Book value is common shareholders equity divided by common shares outstanding.

Free cash flow is revenue less operating expenses including interest expenses and maintenance capital spending. It is the discretionary cash that a company has after all expenses and is available for purposes such as dividend payments, investing back into the business or share repurchases.

Poplar Forest Capital LLC is the advisor to the Poplar Forest Partners Fund which is distributed by Quasar Distributors, LLC.