THIRD POINT

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Fourth Quarter 2008 Investor Letter

Dear Investor:

Third Point Offshore Fund, Ltd returned -17.2% net of fees and expenses in the fourth quarter of 2008 and returned -32.6% for the year ending December 31, 2008. The S & P 500 returned -21.9% for the quarter, and -37.0% in 2008. Firm assets under management at January 1, 2009 were $2.3 billion.

2008 Review

Since its founding in 1995, Third Point's opportunistic investment approach has thrived in a variety of market environments and circumstances, compounding (in the case of our first fund, Third Point Partners L.P.) at an average annual rate of return of 20.1%. I started with a focus on distressed debt, transitioned to equities and added short selling and risk arbitrage into the mix throughout the prosperous period of the late 90's. Market neutral and hedged strategies positioned us well in 2000 and 2001, when we generated double-digit returns despite challenging markets caused by the bursting of the tech bubble. Beginning in 2002, we returned our focus to distressed investing, taking a small loss in 2002 as that market declined, but setting the stage for significant gains in 2003 and 2004. Profits in 2005 through the end of 2006 were generated by a long bias in equity restructurings and other special situations. In 2007, as the U.S. economic outlook dimmed, we profited from our international investments and timely short sales on both financial institutions and the ABX subprime mortgage index.

Set against this long-term track record of successfully navigating broader trends, 2008 was particularly frustrating. Our frustration is even more acute because we had largely correct macroeconomic views, but failed to execute them effectively and timely enough in radically shifting markets. For example, we came into the year certain that the crisis facing the subprime sector would fan out and affect the housing market and financial institutions more broadly. Indeed, while this thesis proved accurate, even as we made money shorting financials we missed opportunities to profit from the contagion effects felt in retail, auto and the broader economy.

In hindsight, one of our most fundamental mistakes was underestimating the speed with which the economy could deteriorate. During the first half of the year we made money in our energy portfolio, leading to positive returns. However, we should have known that the economic environment, combined with high oil prices, would severely impact the price of hydrocarbons at some point. Unfortunately, we increased energy exposure just as we should have been taking profits into June. We all know what occurred next: the reversal was swift and merciless and we paid the price. That said, we did significantly reduce our gross and net exposure in the energy space in July, but still felt the pain of these investments over the balance of the year.

July turned out to be the first month of the worst losing streak in the firm's history. Despite having taken down our gross and net exposures significantly in order to preserve capital, the volatility and the panic that spread throughout the markets made almost every bet treacherous, even those we believed had significant margins of safety. In addition to energy losses, we prematurely covered a portion of our short book in September when the government banned short-selling in financial and other stocks after the collapse of Lehman and AIG.

I have learned a very painful lesson about investing in less liquid positions. There are times in which the market rewards investment in less liquid situations with extraordinary returns. In the past such investments included our stake in AEP, in which we purchased an unregistered block of the company's common stock, Radia Communications, a private semiconductor start-up which ended up a home run for our investors, and many others which turned out well. Unfortunately, our investment in Chrysler equity and a position in Target that we held partially through a committed lock-up lost almost all of their value during the year. The Chrysler investment has fallen to 2.5% of face and we have extricated ourselves from the Target vehicle completely as of the end of February. Needless to say, we will not make these types of investments again.

In all, there is not much to be proud of from 2008. However, I am pleased that we took numerous capital-preservation measures that mitigated more severe potential investor losses, allowing us to live to "fight another day". In any event, we take full responsibility for our performance. It is too convenient to hide behind the mama's apron of "challenging market environments," and "black swan events" while exhorting clients to ignore poor performance and to think like "long-term investors." I make no such excuses. Mistakes were made, but lessons were learned. We have made significant changes to our portfolio and to our fund management team and if the "proof is in the pudding" we are off to a solid start in 2009 despite continuing "difficult market conditions".

2009 Outlook

Last year's consensus view that the US economy would bottom with fiscal and monetary policy enacted by the new administration looks quaint in hindsight. Instead, most

measures of economic activity have deteriorated at an increasing pace, including unemployment, worse-than-expected Q4 GDP results, and distressing slowdowns in global trade.

Rapid deterioration in Eastern Europe and the Baltic States will have a severe impact on EU members with exposure to those countries through their banking sector. Further evidence of this deterioration is apparent with the collapse of European trade of 30-35% from the prior period.

Further east, the story is no better. Trade is down as much as 40-50% in Taiwan and Singapore. Chinese exports are down 17% but imports are down a staggering 40% (all of this notwithstanding official protestations that China is still on target to grow at 8%). Anecdotal evidence of Dubai-like vacancies in office towers, and unemployment marked by reverse immigration to the countryside by workers unable to find factory jobs in the city tell the actual story. This is indeed a global and interconnected economic crisis and there is no safe haven.

Illiquidity vs. Insolvency

Monetary and fiscal policy can address only issues of liquidity, not solvency. We are facing an issue of global insolvency that can be addressed only by massive corporate and sovereign restructuring.

What we have before us is an economic crisis caused by excess leverage in virtually every nook and cranny of the economy. Individuals are carrying too much consumer and mortgage debt. Financial institutions are frighteningly over-leveraged, even after injections of new equity. Corporations in a variety of industries borrowed too much in the good times and are left without cushion. Private equity-backed firms "LBO'd" during the boom times are like death row inmates awaiting their execution at the first maturities on their covenant-free debt.

Issues of insolvency affect other institutions as well. The same intellectual dishonesty that afflicted accounting at the nation's banks is now rearing its head in the pension liability line-item for companies with "defined benefit" plans. I recently read the 10-K for a major steel company based in the US whose pension liability went from a surplus of $200 million at the end of 2007 to a deficit of approximately $2.0 billion at the end of 2008. With equities down 20-25% year to date we suspect the $2.0 billion deficit has already widened. In addition, this company also uses aggressive predictions for its plan assets – utilizing an overall 8% return assumption, when the entire pension has an allocation of only 50% to equities. In other words, if the pension plan assumes a 5% return in its fixed income portfolio (which, in this market, is by no means assured), it has to be assuming an 11% return on its equity portfolio. Failure to meet these returns will exacerbate the underfunding. To add insult to injury, in addition to its pension liability, this company's healthcare plan is underfunded by $3.0 billion. Given our view of the company's deteriorating operations, coupled with these liabilities, we have

initiated a short position to benefit our investors should the price of the shares more accurately reflect our concerns.

George Soros popularized the term "reflexivity" to describe the concept of a self-reinforcing feedback loop that reinforces certain economic trends. Unfortunately, it will be difficult to break free from the vortex of excessive debt, declining valuations, declining pension valuations, questionable private equity marks and a deteriorating economy. Entire industries – and increasingly, entire countries – are poised to go bankrupt. There are so many players moving around promising to save the day, but until they arrive at the right conceptual framework to understand the problem, they won't be able to solve it. In my humble view, excessive debt got us into this crisis and only eliminating the debt will get us out of it. Until then, we need to, in the words of Captain "Sully" "brace for impact."

Don't Worry, Be Happy

http://www.dailymotion.com/video/x2b3xk_bobby-mcferrin-dont-worry-be-happy_music

The economy and world markets may be in economic chaos, but we at Third Point are very optimistic about the opportunities we are seeing in two primary areas: market neutral strategies and short selling.

We have two merger arbitrage transactions set up for approximately 18% annualized returns. Also, just this month, the announcement of a distressed company's exchange offer provided the opportunity to make more than a 20% gross return in less than 6 weeks. We were able to put almost $100 million to work and have made over $12 million in just a week with very little risk. This sort of trade requires instant analysis and a quick trigger, and is something I believe we do as well as anyone else. We expect to repeat this type of trade as similar restructurings inevitably take place by companies desperate to stave off bankruptcy.

Likewise, we have bought senior bonds in a bankrupt concern for 84 cents on the dollar which, based on our analysis, should recover par before year end and may even earn accrued interest. The bonds are fully covered by cash at the holding company and our downside case is a gross return of 19% and an IRR of more than 25%.

We have short positions in European banks and sovereign debt mostly in the form of CDS positions. These investments are an extension of our views on the global banking sector, where we have spent a lot of time during the past twelve months. We continue to believe that banks are hugely overlevered with deteriorating assets, and that Europe is about a year behind the US in confronting this deterioration. The issue becomes even trickier in certain countries where banking sector liabilities make up an even larger percentage of GDP than in the United States. These sovereign balance sheets are comparatively weak and massive bailouts, on the scale required in the United States, won't be possible.

As discussed above, our view has evolved during the first two months of the year to be even more bearish than consensus. We have reflected this in our short positions in cyclical stocks, including in the materials sector. Many stocks have already seen their values fall substantially, but we think the market overall is still missing the pension liability story, as outlined above. As a result, they are effectively over-levered and with prices for their goods continuing to fall, they face potential catastrophe.

Finally, we have found a classic Third Point short position. Wall Street has developed a consensus view since the downturn started that people are going to need to be retrained, consistent with past recessions. There has been an expectation that the US government will provide funding and subsidies for these educational re-trainings, and so value investors have been piling into for-profit education stocks. These stocks have been trading at historically low valuations recently, as a result of last year's vacuum in the student lending market. However, we have identified specific companies that we believe are failing in the fundamental task of delivering services of value to their students. It is only a matter of time before the government gets wise to this abuse (money for nothing) and discontinues subsidizing matriculation in these "institutions", which are really no more than websites. Our resultant short position has already produced profits, but we expect much more in the near to mid-term.

The TALF Opportunity

One area we are decidedly NOT interested in is the "opportunity" to purchase structured debt in student loans, credit card and auto-loan receivables with non-recourse leverage from the US government. Wasn't it just last year that various private equity firms and some hedge funds purchased big chunks of unsold high yield bank loans with non-recourse debt from the banks at "bargain" prices in the low 90s/high 80s? In case you didn't notice, those "experts" in leveraged finance recently wrote those investments down to zero and returned the collateral to, you guessed it: the banks.

One of our guiding principles is that we do not use financial alchemy (leverage) to turn mediocre returns into gold. Accordingly, we'll pass on the TALF "opportunity" and leave it to the experts in applying leverage to mediocre investments.

Bad News Bears

We are not "permabears" and recognize that stocks could rally well before we emerge from this economic quagmire. We are also excited about the prospects of investing in distressed debt securities at such time that valuations meet our return requirements and satisfy our need for a margin of safety. Thus far, we do not believe there has been sufficient capitulation in the market and we await the opportunity to effectively create equity or other cheap securities in restructured companies at attractive valuations.

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Business and Investor Changes

As one of the largest investors in our fund and an investor in several others, I am particularly annoyed by the rampant "gating" that has occurred across our industry, which, when used to obfuscate actual results or otherwise as a matter of convenience, violates the social contract managers have with their investors. I am proud to say that despite redemptions of a significant amount of our capital, we have met all of our obligations timely in cash. We will do the same to meet redemptions for March 31, 2009. Given the promising investment climate, I am pleased to be in discussions with many current and potential investors who are interested in making fresh investments in the fund.

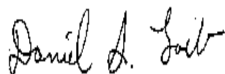
Personnel Update

I am pleased to announce that Ian Wallace and Gregg Gardiner, as well as their assistant Kristie O'Brien, have joined Third Point as full time employees. They come to us from River Run Management to work with me on distressed and credit investments. Although Ian was not employed by Third Point, he resided in our office space from 1996-2003, during which time he founded River Run. During that period, I was able to witness his considerable skills as we both took ultimately successful positions in certain investments, including Dade-Behring, LEAP Wireless, Magellan Health, International Coal, Warnaco, and Stage Stores. I am pleased to have Ian formally on the Third Point Team at the beginning of this potentially very exciting time in the distressed space, and welcome you to meet him.

Brad Radoff left Third Point in February after having re-joined in the middle of 2006. As many of you recall, this was his second tour of duty with the firm having been at Third Point previously from 1996 until 1999. We thank Brad for his contribution and wish him continued success.

In conclusion, after suffering through a year like 2008, I believe that the best thing to do is to stand up, take your lumps and clear the portfolio of "dead wood." With that exercise sufficiently behind us, I am liberated to focus solely on making this a profitable year for our investors. Thank you for trusting me with your capital, and know that my team and I are working day and night to recoup your losses and produce absolute returns in 2009.

Sincerely,



Daniel S. Loeb

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[1] The data in the table is presented by funds managed by Third Point LLC and excludes managed accounts. Individual fund performance, portfolio exposure and other data included herein may vary between the various funds and managed accounts managed by Third Point LLC. Performance results are presented on a net-of-fees basis and reflect the deduction of, among other things: management fees, brokerage commissions, administrative expenses, and accrued performance allocation or incentive fees, if any. Net performance includes the reinvestment of all dividends, interest, and capital gains. In practice, the incentive fee is "earned" on an annual basis (quarterly basis for Third Point Ultra Ltd.), not monthly, or upon a withdrawal from the fund. Quarter-to-Date and Year-to-Date performance is an estimate. Because some investors may have different fee arrangements and depending on the timing of a specific investment, net performance for an individual investor may vary from the net performance as stated herein.

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