PABRAI INVESTMENT FUNDS

114 Pacifica, Suite 240
Irvine, CA 92618-3321
USA

Tel. +1949.453.0609
mp@pabraifunds.com
www.pabraifunds.com

To: All Limited Partners and Investors of the Pabrai Investment Funds

From: Mohnish Pabrai, Managing Partner

Date: January 10, 2010

Re: **2009 Results**

Dear Partners:

For the quarter ended December 31, 2009, a total of $14.3 Million was added to the various funds by new and existing partners. The additions on a per fund basis are:

PIF2 (US Accredited): $1.3 Million

PIF3 (Offshore/IRA): $0.5 Million

PIF4 (US Qualified): $12.5 Million

In addition, Dec. 31 was also the annual redemption date. A total of $39.2 Million was redeemed from the various funds. The redemptions are a per fund basis:

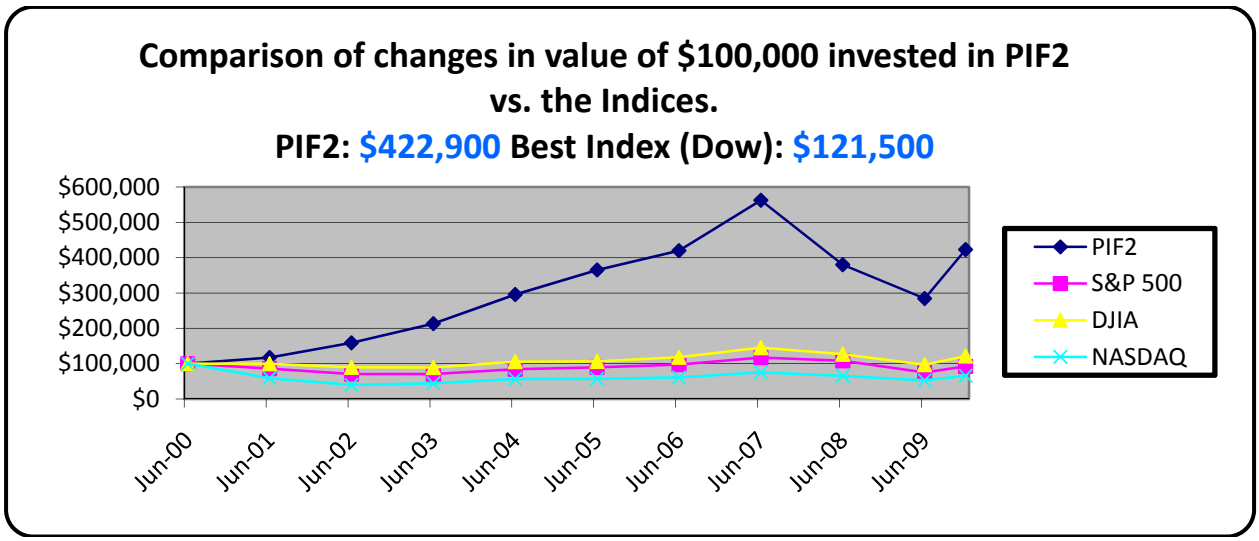
PIF2: $5.0 Million PIF3: $11.9 Million PIF4: $22.3 Million

Included in the above redemptions is $1 Million from PIF2 by Dalal Street, Inc. This is Pabrai family redemptions to cover any residual 2009 taxes, non-reimbursed Pabrai Funds operating expenses and our contributions to The Dakshana Foundation for 2010. I chose to redeem all of it from PIF2 as it is the fund with the largest Pabrai family stake – thus making the absolute amounts invested in PIF2 and PIF4 by the family more balanced.

The updated performance numbers on all the funds are:

PABRAI INVESTMENT FUND 2 (US Accredited Investors) Performance Summary:

	DJIA	NASDAQ	S&P 500	PIF2 (net to investors)
10/1/00 – 6/30/01	-0.2%	-41.0%	-14.0%	+17.4%
7/1/01 – 6/30/02	-10.3%	-32.7%	-18.0%	+35.3%
7/1/02 – 6/30/03	-0.5%	+11.4%	+0.3%	+34.2%
7/1/03 – 6/30/04	+18.6%	+26.8%	+19.1%	+38.7%
7/1/04 – 6/30/05	+0.7%	+1.1%	+6.3%	+23.4%
7/1/05 – 6/30/06	+11.1%	+6.5%	+8.6%	+15.0%
7/1/06 – 6/30/07	+23.0%	+20.7%	+20.6%	+34.0%
7/1/07 – 6/30/08	-13.3%	-11.2%	-13.1%	-32.4%
7/1/08 – 6/30/09	-23.0%	-19.1%	-26.2%	-25.2%
7/1/09 – 12/31/09	+25.2%	+24.3%	+22.6%	+49.1%
1/1/09 – 12/31/09	+22.7%	+45.4%	+26.5%	+122.5%
Annualized	+2.1%	-4.4%	-0.9%	+16.9%
Cumulative	+21.5%	-34.4%	-7.8%	+322.9%

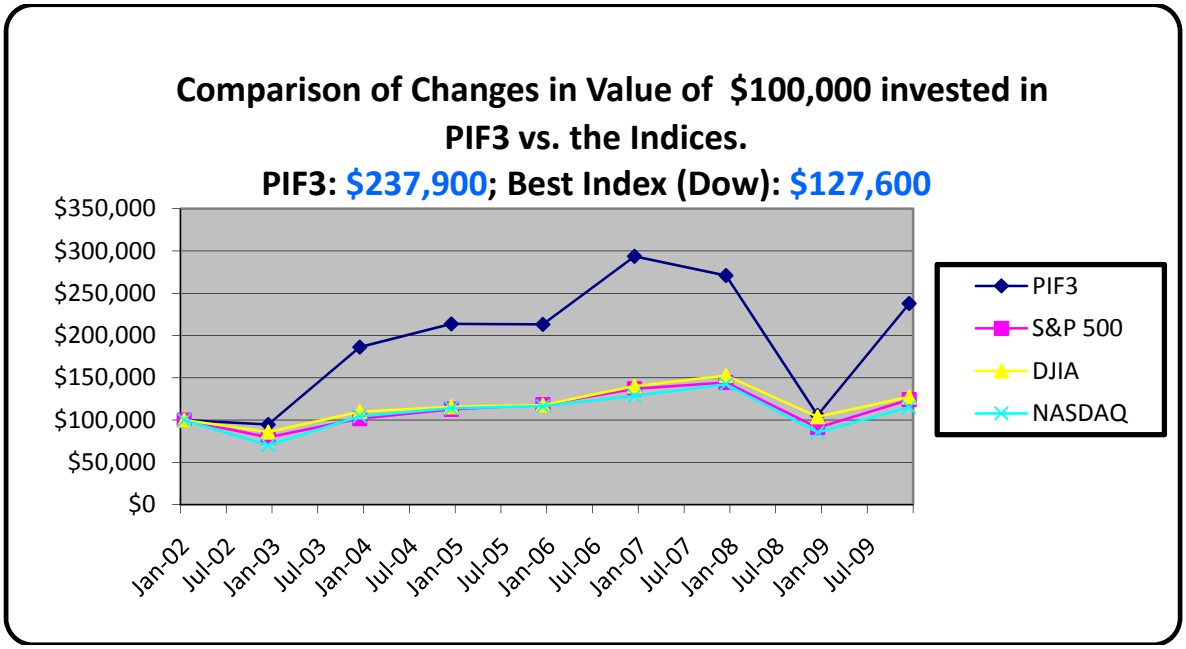


PIF2 Investors:

A $100,000 investment in PIFI at inception on July 1, 1999 and rolled over into PIF2 on 12/31/02 ($197,900) was worth $592,500 as of December 31, 2009 (net to investors). This equates to an annualized return of 18.5% since inception – after all management fees and expenses. The best index over the same period was the Dow and an investment of $100,000 in the DJIA on July 1, 1999 was worth $120,300 on December 31, 2009 – an annualized gain of 1.8%. The Dow gains include reinvested dividends. In the graph above, the start date for PIF2 is shown as June 2000 for readability. The correct start date is October 2000.

PABRAI INVESTMENT FUND 3 (Offshore/IRA Investors) Performance Summary:

	DJIA	NASDAQ	S&P 500	PIF3 (net to investors)
2/1/02 – 12/31/02	-14.1%	-29.9%	-20.4%	-5.2%
1/1/03 – 12/31/03	+28.3%	+50.8%	+28.7%	+96.5%
1/1/04 – 12/31/04	+5.3%	+9.2%	+10.9%	+14.7%
1/1/05 – 12/31/05	+1.7%	+2.1%	+4.9%	-0.2%
1/1/06 – 12/31/06	+19.0%	+10.4%	+15.8%	+37.8%
1/1/07 – 12/31/07	+8.9%	+10.7%	+5.5%	-7.8%
1/1/08 – 12/31/08	-31.9%	-39.9%	-37.0%	-60.9%
1/1/09 – 12/31/09	+22.7%	+45.4%	+26.5%	+125.0%
Annualized	+3.1%	+2.8%	+1.8%	+11.6%
Cumulative	+27.6%	+24.2%	+15.2%	+137.9%

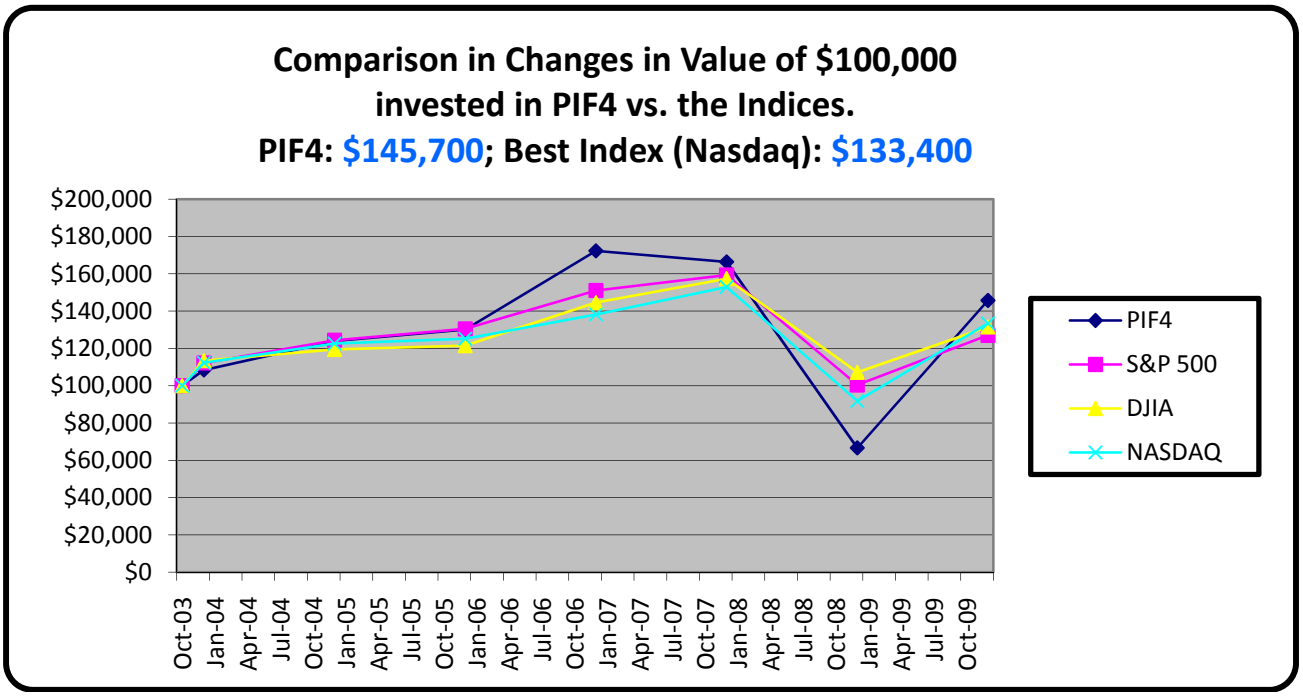


PIF3 Investors:

A $100,000 investment in PIF3 at inception on February 1, 2002 was worth $237,900 as of December 31, 2009 (net to investors). This equates to an annualized return of 11.6% since inception. The best index over the same period was the Dow and an investment of $100,000 in the Dow on February 1, 2002 was worth $127,600 on December 31, 2009 – an annualized gain of 3.1%. The Dow gains include reinvested dividends.

PABRAI INVESTMENT FUND 4 (US Qualified Investors) Performance Summary:

	DJIA	NASDAQ	S&P 500	PIF4 (net to investors)
10/1/03 – 12/31/03	+13.4%	+12.3%	+12.2%	+8.4%
1/1/04 – 12/31/04	+5.3%	+9.2%	+10.9%	+14.4%
1/1/05 – 12/31/05	+1.7%	+2.1%	+4.9%	+4.9%
1/1/06 – 12/31/06	+19.0%	+10.4%	+15.8%	+32.4%
1/1/07 – 12/31/07	+8.9%	+10.7%	+5.5%	-3.4%
1/1/08 – 12/31/08	-31.9%	-39.9%	-37.0%	-60.0%
1/1/09 – 12/31/09	+22.7%	+45.4%	+26.5%	+118.8%
Annualized	+4.5%	+4.7%	+3.9%	+6.2%
Cumulative	+31.5%	+33.4%	+27.0%	+45.7%



PIF4 Investors:

A $100,000 investment in PIF4 at inception on October 1, 2003 was worth $145,700 as of December 31, 2009 (net to investors). This equates to an annualized gain of 6.2% since inception. The best index over the same period was the Nasdaq Composite and an investment of $100,000 in the Nasdaq Composite on October 1, 2003 was worth $133,400 on December 31, 2009 – an annualized gain of 4.7%. The Nasdaq gains include reinvested dividends.

General Comments

2009 was one of the most difficult years for the US economy in over seven decades. All through the year, jobs losses mounted at a pace not seen in over half a century. Paradoxically, as the ranks of the unemployed swelled, the stock market had one of its best years in a long time. Why is that?

Equity markets exhibit a long-term gravitational pull towards intrinsic value. They don't necessarily do well when the economy does well. Nor do they necessarily do poorly when the economy is in the tank. If market indices are below intrinsic value, it is good news for investors and if they are above, then there could be pain (or flat-lining) for a while. We started 2009 with equity prices severely depressed. And thus, even with all the doom and gloom, equities marched upwards towards intrinsic value.

One of the worst years for the US economy thus ended up being the best year ever for Pabrai Funds. All three funds were up 118 to 125% in 2009 and beat all the indices soundly. It's worth keeping all of this in perspective. We have yet to fully make up all the ground we lost in 2008. We are, however, making great progress towards that near-term goal.

While the quarter and annual results look great, my focus has always been on our longer term results. They must be superior to the indices – after all fees and expenses – to justify Pabrai Funds' existence. The funds have delivered on this goal. They have all performed meaningfully better than the indices since their respective inceptions.

All three funds have outperformed the best of the three benchmark indices over periods of a year and five years as well. However, they are all underperforming some of the indices when compared over a three year period. I'm singularly focused on long-term outperformance. Nonetheless, I believe that even three year comparisons will look more favorable in the future.

Concentrated Portfolios: Ten or Twenty Holdings?

The interested reader of these tomes will be aware that Pabrai Funds moved away from a 10x10 model of portfolio diversification (positions sized at 10% of assets with 10 positions making up 80+% of assets) to a 2-5-10 model about 1¼ year ago. The 2-5-10 model simply means that the typical bet is at 5% of assets. Sometimes we make correlated basket bets at 2%. And once in a while, we'll venture as high as 10%.

As I write this, the funds hold 26 distinct positions. The 15 largest positions make up over 72% of assets. The 11 smallest make up about 15%. And cash, net of redemptions, currently exceeds 12% of assets. I've had a little over a year's worth of

experience running a more diversified portfolio – and am more convinced than ever that this is the right balance.

We've rarely had much in terms of cash balances for extended time periods when we ran our ten stock model. It wasn't very hard to find a handful of undervalued stocks and thus we ended up being nearly fully invested most of the time. I find that it is much harder to get to being fully invested with the 20-30 stock model. We did get fully invested a year ago – and we could have put nearly limitless quantities of cash to work in Q408 and Q109. That was because large portions of the equity markets went on sale – with loads of bargains everywhere.

When we are at elevated market conditions, or even normal market conditions, our cash position is likely to be build up. And when Mr. Market get depressed, we're likely to be all-in. We're not timing the market, but the natural ebb and flow that this 20-30 stock model causes leads to more buying activity during depressed times and less buying during euphoric ones. This effect may not be altogether miniscule. It could well be that we deliver better results with a 5% average bet size that we did when bets were sized at 10%.

The written checklist that I also introduced about a year back has also been a wonderful addition. Running through the 70+ item checklist does not take much time, but it is fundamental to a reduced error rate. We are batting with zero errors (of commission) since the checklist was initiated. I'm sure we'll have our share of bloopers in the future, but I fully expect our error-rate to be much lower than the pre-checklist era.

Atul Gawande's Book "The Checklist Manifesto" – Highly Recommended

The only reason why Pabrai Funds use a written checklist for investing is because a person named Dr. Atul Gawande decided to join us on planet Earth. I was thrilled when Atul told me in the summer that he was writing a book entitled, The Checklist Manifesto. Atul is a gifted writer and a multi-disciplinary thinker. He couldn't have picked a better subject. The book is out and highly recommended.

Alignment of Interests

All three funds are below their historic NAVs and hence no fees were earned by any of the funds for the quarter. My immediate family has a stake of 455,562 units of PIF2; 8417 units of PIF3; 1,224,824 units of PIF4 and about 23,500 units of PIF4 in a retirement account. This stake is worth over $37 Million.

Besides the previously disclosed stake and small investment in Dardashti Capital (worth about $1.2 Million), my family has no interests in any other mutual funds, hedge funds or

private equity funds. I have a deep vested interest in the future performance of Pabrai Funds.

Pabrai Funds charges no management fee, just performance fees – which are ¼ of the returns over 6% annualized (subject to high-water marks). I only get paid when you make money. When you win, I win. Our interests are completely aligned. I am very bullish on the long-term future of Pabrai Funds – as demonstrated by my being the single largest investor in the funds. Investors who add funds when we are below the high-water mark (like now), get a free ride (no fees) until we're back at the high water mark plus 6% annualized from that date. It is a great deal.

2010 Annual Meetings – Save the Date

As is our usual modus operandi, there will be two annual meetings sequentially at Chicago, Illinois & Orange County, California.

The **California** meeting is scheduled to be on **Saturday, Sept. 11, 2010** at 4:00 PM at our usual venue:

Hyatt Regency Huntington Beach Resort and Spa
(Grand Ballroom)
21500 Pacific Coast Highway, Huntington Beach, CA 92648 Tel. +1714.698.1234

We will have 10 rooms set aside for the event at a TBD rate. Please call the hotel directly and book your room mentioning Pabrai Investment Funds. Alternately, Hyatt.com usually has good rates and you can book online as well. Please book early as the hotel usually is fully booked around that time. The hotel is closest to Orange County Airport (SNA), though LAX and Long Beach (LGB) are convenient as well.

The Chicago meeting is thus scheduled to be on **Saturday, Sept. 25, 2010** at 4:00 PM at Carlucci's Restaurant
(The Auditorium)
6111 North River Road, Rosemont, Illinois 60018 Tel. +1847.518.0990

Carlucci's is a five minute taxi ride away from O'Hare airport. The Marriott Suites O'Hare and The Westin O'Hare are both next to the restaurant. In addition, there are a plethora of hotels in the vicinity. Good deals on O'Hare hotels are usually available on the major travel-related websites.

Agenda:

4:00 – 4:30 PM: Meet and Greet
4:30 – 6:30 PM: Presentation and Q&A
6:30 – 7:15 PM: Cocktail Hour

7:15 PM: Dinner

The invites will go out in July 2010. Your significant other and kids of all ages are welcome to attend. I look forward to seeing you in September.

Next Opening – April 1, 2010 (all funds); February 1, 2010 (PIF3)

There are two funds open to new investors to add funds - PIF3 and PIF4.

The minimum investment for PIF4 is now reduced to $1,000,000 and one needs to be a "qualified investor" as defined by the SEC. The offering and subscription documents for PIF4 have details on who is considered a qualified investor. Next opening is April 1, 2010.

To invest in PIF3, one needs to be a non-US accredited offshore investor. Tax-exempt accounts like IRAs, Roth IRAs and US Family Foundations can invest in PIF3 as well. The minimum investment to join PIF3 as a new partner is $10,000,000 for US Tax-exempt accounts and $1,000,000 for offshore investors. Next opening date for PIF3 is February 1, 2010.

Existing partners in any of the Pabrai Funds can add funds in increments of $25,000 at each opening (with a $25,000 minimum).

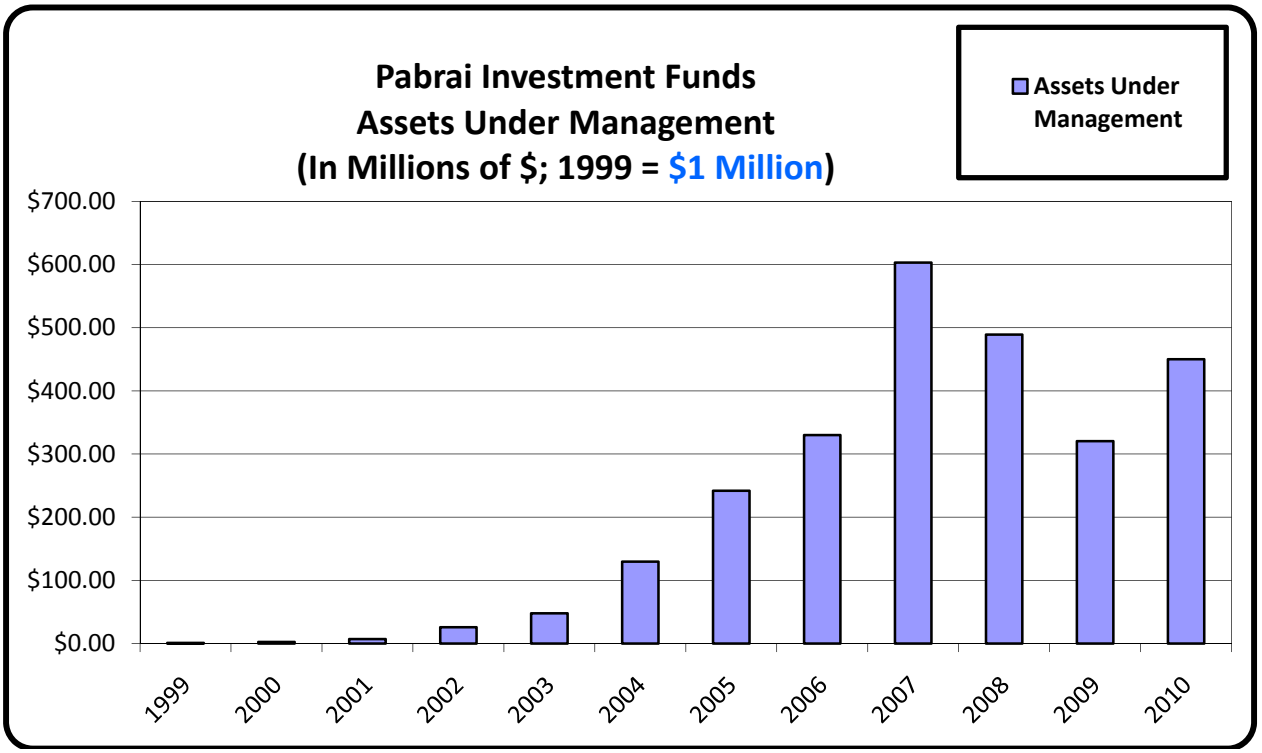
PIF2/PIF4 open once every quarter to add funds from new/existing investors (1/1, 4/1, 7/1, 10/1) while PIF3 is open to add funds on the 1st day of every month.

Final K-1's (for US Investors)

For PIF2 and PIF4 investors, we expect your final K-1s to be emailed to you (password protected) by March 31, 2010.

Assets Under Management

There is over $450 Million in assets under management between all the funds as of January 1, 2010.



Thanks for your continued interest, referrals and support. Feel free to call me at +1949.453.0609 or email me at mp@pabraifunds.com with any queries or comments.

Warm regards,

Mohnish Pabrai

Appendix A

PIF2's Performance History (Net to Investors)

No. of Units	Date	PIF2 NAV
110,000	10/1/2000	$10.00
330,014	6/30/2001	$11.74
1,027,795	6/30/2002	$15.89
1,950,982	6/30/2003	$21.32
2,445,212	6/30/2004	$29.58
2,696,687	6/30/2005	$36.52
2,646,687	6/30/2006	$41.99
3,013,111	6/30/2007	$56.25
2,934,990	6/30/2008	$38.01
2,468,091	6/30/2009	$28.45
2,476,137	9/30/2009	$40.39
2,389,042	12/31/2009	$42.29

PIF3's Performance History (Net to Investors)

No. of Units	Date	PIF3 NAV
65,100	2/1/2002	$10.00
265,919	12/31/2002	$9.48
485,041	12/31/2003	$18.63
1,774,753	12/31/2004	$21.37
2,478,793	12/31/2005	$21.32
2,930,608	12/31/2006	$29.37
6,438,615	12/31/2007	$27.09
5,415,189	12/31/2008	$10.57
5,038,658	12/31/2009	$23.79

PIF4's Performance History (Net to Investors)

No. of Units	Date	PIF4 NAV
595,030	10/1/2003	$10.00
1,219,330	12/31/2003	$10.84
5,627,712	12/31/2004	$12.40
9,314,803	12/31/2005	$13.01
11,528,331	12/31/2006	$17.23
16,899,746	12/31/2007	$16.64
15,737,042	12/31/2008	$6.66
15,725,066	12/31/2009	$14.57

Past performance is not indicative of future results. Returns are presented net of all fees and expenses, include the reinvestment of income and are calculated using a simple rate of return. The securities discussed do not represent all securities recommended for the Funds. It is also not a recommendation to buy or sell and one should not presume they will be profitable.

Please be aware that our past newsletters may discuss specific securities that have performed well without necessarily addressing those that have underperformed within our Fund(s). Readers should not infer that all investment decisions within the Funds were profitable.