

Mirzam Capital Appreciation Fund
July 2008 Fund Commentary by Albert Meyer

Volatile Markets The month of July 2008 was characterized by considerable volatility. The S&P500 posted daily changes of more than 1% in 13 of the 22 trading days. Early in the month, the market declined -4.68% in the space of five days only to bounce back with a three-day +3.74% surge. By July 24, 2008, the S&P was down -3.5% and investors were bracing for another hugely disappointing month, but a +2.69% fight back brought relief and the index ended only -0.99% worse for wear. This meant that the S&P was now down -12.8% for the year.

Fund Performance Mirzam was not able to withstand the turmoil and weighed in with a -4.36% decline for the month. Year-to-date the fund is down -2.0%, but still up +3.67% since inception (August 20, 2008), a period during which the S&P500 declined more than -12%. As the saying goes, misery likes company. Warren Buffett's Berkshire Hathaway (BRKA) is also taking strain, down -5.7% since August 20, 2008, and -19.1% for the year to date, trailing even the S&P500. The declining market has given us an opportunity to buy great companies at prices that we believe are well below their intrinsic values. The fund is now 15% in cash compared to 24% last month and 32% at the end of the first quarter of 2008.

Portfolio Characteristics Last month, during the market upheavals, we said that the best medicine is to keep a cool head and concentrate on the companies that make up the portfolio. We provided an overview of the stocks in the portfolio and it is worth revisiting last month's commentary.

The intrinsic worth of any security is the discounted value of future cash flows. To determine future cash flows is a judgment call based on several assumptions. The rates at which such future cash flows are discounted are also subject to assumptions and related to one's assessment of the risks of holding such a security. High risk requires a high discount rate. We go through this exercise for every stock that we buy. However, for the purpose of this month's commentary, we will focus on past cash flows as we consider the free cash flows generated by all the companies in the Mirzam portfolio in 2007.

We extracted the numbers from the SEC filings. The companies in the Mirzam portfolio have a combined market capitalization of \$1.1 trillion and an average market capitalization of \$26 billion. The average market capitalization of the 500 companies in the S&P500 is \$22 billion. The free cash flows generated by the companies in the Mirzam portfolio in 2007 as a percentage of their market capitalization was 6.27%. Because the Mirzam portfolio is weighted toward companies that are prolific generators of free cash flow, on a weighted average basis, the weighted average free cash flow yield of the portfolio is 10.09%.

The free cash flow calculations include the cash that companies spend on capital expenditures (subtracted from cash generated by operations). Capital expenditures have two components: maintenance (ongoing or recurring) capital expenditures and

expenditures that are geared toward expanding the business, the latter component being of a discretionary nature. The companies in our portfolio spent 55% of cash generated from operations on capital expenditures. If we assume that roughly 10% of this comprised discretionary expenditures, and exclude this to arrive at an adjusted free cash flow number, the adjusted weighted average free flow yield of our portfolio rises to approximately 10.94%. We believe this yield provides us with a fair amount of margin of safety.

The average dividend yield on the S&P500 is 2.1%. The current weighted average yield of the Mirzam portfolio is 3.7% based on 2007's dividend payments.

How does one interpret this dividend spread? One way would be to say that if the companies in our portfolio traded at a yield of 2.1%, they would be trading at market values that are 50% higher than their current values. This is another way of saying that they are currently trading at a discount of approximately 33% to the S&P500, measured on the basis of dividend yield as calculated above. In other words, if the S&P500 companies were to lose more than 40% of their market value, the index would offer a yield of 3.2%.

Here are three questions that Mirzam investors need to ask themselves: (a) Am I comfortable with the stocks that are in the portfolio? – refer last month's commentary; (b) Am I comfortable with the cash generating abilities of the companies in the portfolio?; and (c) Am I comfortable with the discount at which the portfolio is trading relative to the S&P500? If the answer is "yes" to all three questions then we believe this is not the time to make the decision to withdraw funds just because Mr. Market can't make up its mind about whether this bear market should persist or not. We do not believe it makes any investment sense in committing funds to us unless the investment objective is to hold the position for a number of years.

As we emphasized last month, the value that the market is currently placing on our stocks certainly plays on one's mind, but in an environment of panic selling, even great companies inevitably trade below their intrinsic values. The Mirzam portfolio comprises a collection of businesses acquired during a time when the market was in free fall. We bought these fractional ownership interests as others sold in panic. A year from now, we'll be able to tell how close we came to buying these stocks at their 52-week lows. Whatever the current state of the market, we believe we own a collection of stellar businesses, with superior fundamentals and considerable competitive advantages. Hold this fund for the long haul. Mutual funds, and particularly Mirzam, are not investment vehicles for short-term trading purposes.

-Albert Meyer

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investing. You may also obtain a current copy of the Funds' prospectus by calling (888) 693-8056.

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