

Mirzam Capital Appreciation Fund  
June 2008 Fund Commentary by Albert Meyer

**No Joy in June** The month of June was horrendous. The S&P500 closed down  $-8.6\%$  for the month. There seems to be no end in sight. Only four of the 30 DOW stocks are positive for the year. Both the S&P500 and the Dow indices are down  $-15\%$  since the end of the second quarter of 2007.

Even Warren Buffett's Berkshire Hathaway has not weathered these storms very well. Berkshire Hathaway was down  $-9.78\%$  this quarter and down  $-14.72\%$  as at June 30, 2008. On July 2, 2008, the *Bloomberg* news service noted that Berkshire was down  $-19\%$  since closing at an all time high of \$149,200 in December 2008, compared to a  $-15\%$  slide of the S&P500 during the same period. Has the maestro lost his touch? Absolutely not, but even revered investors like Warren Buffet can't avoid the volatility of a market in virtual free fall.

**Fund Performance** Based on the total funds on hand at the end of June 2008, only 25% of the portfolio was invested in equities at the end of the first quarter 2008, but 66% of total funds on hand at the time. Large cash inflows in April and May caused us to allocate another 17% and 13% to equities in April and May, respectively. In June, we allocated another 21% to bring the equity portion of Mirzam's portfolio up to 76%. Close to 50% of the portfolio was invested during a period that the S&P500 had sold off more than 7% from its value at the time the fund was established. The fund was 35% in cash at the beginning of the month, a ratio that was brought down to 24% by the end of June.

With the S&P500 now down  $-12\%$  from its May 2, 2008 high, these equity allocations we made in the second quarter inevitably took some water, but we believe we were able to pick up great businesses at very attractive prices, regardless of the fact that currently they might be trading at lower prices. If you combine increased equity allocations with a huge down month, you land up with Mirzam's portfolio posting its largest monthly loss to date:  $-5.83\%$ . Since inception, the fund has only had one negative month. That was in March 2008, when the fund was down  $-0.60\%$ .

Year-to-date, the fund is up  $+2.46\%$  compared to the S&P500's decline of  $-12.83\%$ . Since the inception of the fund, August 20, 2007 to the end of June 2008, the S&P500 declined  $-11.45\%$ . The fund, on the other hand, shows a positive  $+8.40\%$  return.

**Portfolio Characteristics** In times of such market upheaval, the best medicine is to set aside one's emotions and consider what is in the portfolio. The MIRZX portfolio is 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.

Our fundamental research-focused approach leads us to companies that trade at compelling valuation multiples, more so in times when the broad market sells off. We are attracted to companies that we feel dominate their industries, benefit from strong secular trends, are relatively immune to economic cycles, and enjoy a virtual monopolistic position in the market place. Southern Copper, Free-Port McMoran, TransCanada, Aluminum Corporation of China, China Mobile, Teva Pharmaceuticals, Tenaris and ArcelorMittal, for example, fit this bill.

We own a number of positions in mobile phone companies in countries where they command huge market share, where competition is minimal, and where they mainly operate on a prepaid business model, which eliminates a lot of credit risk and generates huge amounts of cash flow. The mobile phone is one of the most significant inventions of our time.

In general, we avoid companies that don't pay dividends. We also like to add companies to our portfolios that are committed to relatively high dividend payout ratios. Often these companies are not great growth stories, but the cash flow that they produce for a portfolio comes in handy. Warren Buffett always says that Sees Candy has not grown much in the years that he owned it, but the cash flow it produced has been invested very profitably.

Ultimately, we invest for the long-term, which means our portfolio turnover is minimal. We look for companies that will not only be around ten years from now but will maintain their competitive advantage and preferably enhance their market dominance. In the short-term, market declines will have a negative impact on our portfolio, but our experience is that if you own the right companies, with most of them paying attractive dividends, the portfolio will recover more swiftly than the broad market.

**Oil and Gas** At June 30, 2008, oil and gas related stocks comprised 20% of MIRZX's portfolio. There currently exists a delicate balance between production and consumption of oil and gas, with oil and gas companies having to drill deeper and in more unconventional fields to replenish dwindling reserves. Here are some of the names we own in this space. One important player in oil and gas exploration is Precision Drilling [PDS], a Canadian company. The dividend yield on the stock, based on Mirzam's cost, is

7.7%. Dividends are paid monthly. CGG Veritas [CGV], a French company, provides seismic data to oil and gas companies on land and sea. This helps the industry identify subsurface areas that might contain oil, as well as manage existing oil reservoirs. It is also one of the largest manufacturers of seismic data acquisition equipment. Tenaris [TS] is a leading global manufacturer and supplier of seamless steel pipe products and associated services to the oil and gas, energy and other industries. The company has production, distribution and service capabilities in key markets worldwide. Principal products include casing, tubing, line pipe, and mechanical and structural pipes. TransCanada [TRP] is the largest natural gas transmission company on the North American continent. It also owns a well-balanced portfolio of power generating facilities. PetroChina [PTR] and Statoil [STO] are oil and gas producers, although PetroChina is vertically integrated, with a vast network of pipelines, refineries, storage facilities and service stations. Pengrowth Energy Trust [PGH] is an oil and gas royalty trust that distributes most of the cash that it generates from operations to shareholders (unitholders). It also pays dividends on a monthly basis and the dividend yield, based on Mirzam's cost, is 13.5%.

**Foreign Telecom** Another large component of the portfolio comprising 14.6%, is foreign telecom companies serving over 800 million subscribers in Asia, Eastern Europe and South America. In 2007, the companies in Mirzam's portfolio reported year-over-year revenue growth in the aggregate of 18.8%, which translated into EBITDA growth of 35.7% and growth in cash generated by operations of 28.3%. The weighted average EBITDA margin expanded to 46.4% in 2007 from 40.7% in 2006. Subscriber growth was 21.4%. Based on trailing 2007 EBITDA and the current combined enterprise value (EV) of the companies, the EV/EBITDA multiple is 7.55. The weighted average dividend yield of these stocks is 2.52%. If we assume that a 15% increase in revenue in 2008 will translate into EBITDA growth of 22.5%, the EV/EBITDA multiple will drop to 6.1 at current enterprise values. The dividend yield will rise to approximately 3.1%. On the other hand, if the market responds favorably to these growth numbers and current market valuation multiples are maintained, the value of the portfolio will increase by more than 20%.

**Steel and Metals** Eleven percent of the portfolio is invested in the steel and metals industry. ArcelorMittal is the world's largest steel producer. Aluminum Corporation of China is the third largest producer of aluminum in the world and operates as a virtual monopoly in China. Carpenter Technologies and Titanium Metals process nickel, titanium, chromium, iron scrap and other metal alloying elements. Ternium is the twin of Tenaris – see above – owned and operated by the same people. It is one of the largest steel producers in Latin America.

**Copper** Growth in China and India is driving the demand for electricity, which in turn calls for the construction of power generators, as well as tons of copper wire to transmit the electricity to consumers. Freeport-McMoran is the world largest copper producer. Southern Copper is the world second largest copper producer. These two companies make up 4% of the portfolio. Companies involved in the Food and Agricultural sector comprise another 3% of the portfolio. Twelve percent of the portfolio comprises high dividend yield stocks with a current weighted average dividend yield of 11.4%.

The largest position in the portfolio (3.4%) is Teva Pharmaceuticals, a company that manufactures and distributes generic drugs in 50 countries. The fundamentals of the generics industry are very favorable as governments, health insurers, corporations and individuals seek more affordable drug prices. Governments across the globe are passing legislation that encourages generic drug companies to challenge the patents of brand name drugs on expiration. Ageing populations and the significant number of patents that have attracted huge revenues expiring over the next couple of years have given management the confidence to project a doubling of the company's business over the next five years.

The remaining 18% of the portfolio is invested in thirteen companies that comprise on average less than 1.5% of the portfolio. There are 43 stocks in the portfolio, with foreign companies making up 64% of equities.

The value that the market is currently placing on these stocks certainly plays on one's mind, but in an environment of panic selling, even great companies inevitably trade below their intrinsic values. For some companies in the portfolio, it would appear that our timing was off and we should have waited. Our approach, however, is not to sit on cash and time the market. The time to judge the most recent purchases that make up about half of total stocks in the fund is a year from now when hopefully the market will be back to some semblance of normality. Whatever the current state of the market, we believe Mirzam's equity portfolio represents a collection of stellar businesses, with superior fundamentals and considerable competitive advantages. We plan to hold onto them for a very long-time.

-Albert Meyer

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