

Mirzam Capital Appreciation Fund
March 2008 Fund Commentary by Albert Meyer

A Quarter to Forget Investors won't look back on the first quarter of 2008 with any regret. The S&P500 closed down -9.9% for the quarter and -0.6% for the month of March. The silver lining is that in late January the S&P500 was down as much as -13.5%. The market posted a negative return of -3.48% in February. By comparison, March calls for a sigh of relief.

Fund Performance Mirzam was up 1.52% for the quarter and down -0.6% in March. Since the inception of the fund, August 14, 2007, to the end of March 2008, the S&P500 declined -8.5%. The fund, on the other hand, shows a positive +7.39% return. Last month we said that it was far too early to pat ourselves on the back and that the next six months would be challenging. March was indeed so, but it allowed us an opportunity to allocate more capital as some sold in panic and gifted us their stock at attractive prices.

Portfolio We increased our equity holdings by 19% and reduced our cash holdings to 33% of the total value of the portfolio. At the end of March 2008, the fund's equity holdings were split 64%:36% between foreign and domestic stocks, respectively. The average dividend yield on the equity portion of the fund's portfolio is currently 3.32%. Our largest position is Precision Drilling Trust [PDS], Canada's premier driller. Our yield at the time of purchase was 10%. The stock is up 33% since purchase. Our second largest position is in TransCanada (TRP), another Canadian company and owner of the largest natural gas pipeline network in North America. The current yield is 3.7%. Canadian companies treat shareholders well, pay modest salaries to executives by comparison to US companies, and don't rely on stock base compensation or if they do, sparingly so.

Mark-to-Market: Part 2 Last month, we touched on the mark-to-market or fair value issue that has turned into a doomsday device as far as the financial markets are concerned. The debate is ongoing. This month, we view some comments of executives in the industry. Note that on the last day of the first quarter, the SEC publish guidelines that give firms leeway to value illiquid asset-backed securities in cases where market prices or other relevant pricing information cannot be obtained.

In the third quarter of 2007, Swiss Re marked its asset-backed securities in the form of collateralized debt obligations down to zero and its sub-prime securities down by 62% of their original value. Jacques Aigrain, chief executive of Swiss Re, attributed the severe write-downs to the lack of a true liquid market for these securities. Management concluded that these extreme write-downs are not predictive of future realized losses that might ensue.

In a recent conference call to investors, AIG's CEO, Martin Sullivan, noted that in valuing some of the company's securities, the company "could not find observable data points in this highly disrupted and illiquid market... We continue to believe that the unrealized market valuation losses on this Super Senior Default swap portfolio are not indicative of the losses AIG may realize over time... Even while retaining their

investment grade ratings, these securities were priced at a severe discount to book. This despite our continuing intent and ability to hold them and despite structures that would indicate a substantial amount will continue to perform in accordance with the original terms... any realized losses in the portfolio will be materially below the GAAP fair value.”

At the end of February 2008, Claude Bébéar, one of the most influential voices in French capitalism, launched a stinging attack on international accounting rules. Mr Bébéar, founder and chairman of Axa, told the *Financial Times* that the introduction of accounting rules that required companies to state assets at the latest market prices had helped contribute to global financial market volatility.

Henri de Castries, chief executive of Axa, backed the chairman and said that this manner of fair value accounting was a “conceptual mistake... It is not because your neighbor is selling his house at a distressed price that your house is worth a distressed price if you don't need to sell it.” According to Castries, the system had created accounting losses that were not necessarily economic losses. He was “pretty convinced” that a significant proportion of write-offs would be reversed in a few years. “The accounting systems in the economy are the thermometer, and I'm not sure their measurement scale is the right one today,” he said.

MBIA, the bond insurer, was forced to take mark-to-market losses in one quarter that were more than three times higher than the total amount paid out in losses to policyholders over the past 33 years. Management explained that these accounting hits are “not predictive of future claims” and “should reverse over the remaining life of the insured credit derivatives,” with actual losses not exceeding \$200 million. The company's CEO reiterated that much of the eye-popping credit losses exist only on paper. MBIA has not actually unwound credit swaps or paid out settlements on them. MBIA is the controlling party and there is nothing to compel the company to cash in before maturity. “No serious analyst expects that we will have \$7 billion of economic losses on our portfolio.” Yet, GAAP rules say otherwise.

Steve Forbes, Editor-in-Chief at *Forbes*, writes in an editorial, “It's preposterous to try and guess what these new instruments are worth in a time of panic. Such assets are being marked down to increasingly arbitrary low levels... when forced by panicky regulators and lawsuit-fearing accountants to write down the value of these securities, institutions will dump assets in a market where there are temporarily few or no buyers. The result is a spiraling disaster. So let's have a time-out on markdowns until we actually have *real* experience in what kind of losses are actually going to occur.”

If and when these losses reverse, as promised by these executives, we will brace ourselves for another asset bubble in financial stocks as the pendulum swings to the other extreme. In due time, the Financial Accounting Board (FASB) will revise these much maligned mark-to-market rules, but they will take no responsibility for the mayhem they have caused in the markets.

There is another side to the story, FASB's side. We'll review that next month and connect the dots. In the mean time, the defenders of mark-to-market accounting of which there are many, still need to explain to management and investors why the mark-to-market losses lack predictive value, a qualitative characteristic of accounting information that is vital to the investment process.

-Albert Meyer

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