

Mirzam Capital Appreciation Fund
October 2007 Fund Commentary by Albert Meyer

There were three distinct periods in October. The market rose more than 2.5% during the first eight to nine trading days, only to crater 4% during the following eight days, 1.5% below the month's open. It then recovered to eke out a 1.48% increase for the month as measured by the S&P500. The first trading day in November proved that this extraordinary volatility is here to stay for the foreseeable future. The market was down more than 1.3% soon after it opened and showed no willingness to snap back into positive territory.

We used the days of panic selling in October as buying opportunities. Thirty-four percent of the portfolio is now invested in equities compared to 23% a month ago. The holdings are more or less evenly split between foreign and domestic stocks. The average dividend yield on the equity portion of the fund's portfolio is currently 2.75% based on the cost prices of the equities in the portfolio. The dividend yield based on the market values of the equities in the portfolio is 2.42%, reflecting the 13.64% increase in capital appreciation in the equity portion of the portfolio since inception until the close on October 31, 2007. The S&P500 was up 7.18% during this period. The overall yield on the portfolio at the end of October was 3.97%, reflecting the fact that two-thirds of the portfolio is still in cash. The fund was up 2.30% in October. Sitting on so much cash has not prevented the fund from keeping up with the S&P500 since inception, but at this early stage these comparisons do not matter much to us. The high yield and ample cash resources provide decent protection against a sudden and sharp downturn in the market, which we would welcome. It would provide us with opportunities to buy stocks at bargain basement prices.

There is a raging debate on whether corporations should be democracies or not, that is, should we applaud shareholder activism or is corporate oversight best left to a board of directors? American corporate law severely limits shareholders' rights. By comparison, shareholders live in an activist paradise in the United Kingdom. Lynn Stout, law professor at UCLA, recently pointed out in a *Wall Street Journal* commentary (September 27, 2007), that 13 of the world's largest corporations are in America. Japan, with a notoriously unfriendly legal environment for activists is runner-up with six of the largest firms. "*Yet the U.K. is headquarters to just one and a half of the world's 30 largest companies, BP and Royal Dutch Shell. Even the tiny Netherlands has nurtured more great corporations (2.5 to U.K.'s 1.5). If shareholder democracy were good for corporations and investors, the UK would be a corporate powerhouse... Shareholder democracy is a shallow idea based on a fundamental misunderstanding of what makes good companies tick...*," writes Ms. Stout, to illustrate the detrimental effects of allowing shareholders too much leeway in the boardroom. One could argue that size is not everything, but that does not negate her argument.

Alex J. Pollock, a clear thinker and Resident Fellow at the American Enterprise Institute, in a letter to the editor points out that people who demand a say because they are

“shareholders” are usually not shareholders but hired hands pushing the agendas of their masters, *“bearing their own load of self-interest agendas and agency conflicts.”*

We understand why some shareholders relish the idea of taking on a board of directors, especially when they seek to increase their chances of a favorable investment outcome by, for example, pushing the company towards a certain capital allocation decision in lieu of another course of action, which they see as detrimental to the welfare of shareholders. These shareholders are normally *large* institutional funds, hedge funds, or agents of special interest groups, such as employees, retirees, environmentalists, etc.

We placed emphasis above on *“large”* because management’s rebuttal could always be that if you don’t like what we do, sell your stock. In theory, disenchanted shareholders could just as easily dispose of their holdings and find investment opportunities in companies where the board and management acted in ways that better conform to their world view. There is a problem with this seemingly simple solution. An institution with a sizeable ownership interest in a company would find it difficult to dump the stock on the market without causing alarm and hence driving the stock price down. This is where Mirzam Capital Appreciation Fund comes into the picture. We would love to have the kind of problem described above, but our current size rules us out of any material ownership interests in even the smallest of small cap companies – although we generally cautious of small caps because of the inherent volatility in their stock prices. In addition, they are often just past the start-up phase and their business models have not withstood the test of time.

Here’s our perspective. The SEC requires that we keep a detailed record of all proxies we receive from companies in our portfolio. In addition, we are burdened by the requirement to carefully consider all the matters and resolutions that seek a shareholder vote. We need to tabulate details such as company name, ticker, security ID/CUSIP, a description of all matters or proposals, comparing management’s proposals vs. shareholder proposals, and ultimately how we voted. The voting process in itself is a time-consuming exercise. The SEC deems all this bother and administrative burden a necessary consequence of what we consider a dubious campaign to democratize corporations. Regrettably, SEC requirements make no allowance for the size of a fund’s ownership interest in a corporation. At this stage of our existence as a fund our proxy votes would not have the slightest impact on any shareholder resolution, yet we still have to allocate resources to this futile effort. The SEC wants us to believe that this is in the best interest of our fund and its shareholders. Our shareholders know better. Far from being helpful, these regulations hurt our shareholders. (Does this remind you of that saying, “I’m the government and I’m here to help you.” – thanks, but no thanks) They would far rather have us spend our time and resources on finding and researching the best companies to invest in and be done with what Charles Dickens would have called “mountains of costly nonsense,” to quote a Chancery judge in his novel Bleak House.

- Albert Meyer

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