



GRAY & COMPANY

CAPITAL MARKET REVIEW

Fourth Quarter 2008

CAPITAL MARKET REVIEW

January 2009

Dear Valued Clients,

In the past we have used this page to bring you one of the major financial stories from the prior quarter, such as the collapse of the housing market and the leading indicators pointing to a recession. This quarter we have decided to use this space to share some of our thoughts and concerns about the current investing environment.

We are experiencing a historic era that is drawing comparisons to the Great Depression. The primary source of the current crisis is the abundance of cheap capital and simultaneous poor investing standards. The ramifications produced a society (U.S. and abroad) that, on average, was outspending their income. This led to the housing bubble, which led to the exposure of financial institutions to toxic assets, which led to the freezing of the credit markets. Ultimately, the global economic slowdown resulted from the inability of individuals to maintain their consumption habits.

The impact on publicly traded securities has been severe. The equity markets declined over 30% during 2008. For comparison, the last time we observed performance this poor was during the 1930's. The fixed income market diverged with extreme widening of spreads (good for Treasuries, bad for corporates). Cash investments were also affected, as several money market funds were forced to "break the buck."

These exceptional times called for governmental assistance. The U.S. Government intervened with unprecedented actions - nationalizing the mortgage agencies, bailing out financial institutions, injecting liquidity into the markets, providing credit to stressed companies, lowering the Federal Funds rate to near zero, crafting an economic stimulus package, and implementing other unconventional financial tools. Unfortunately, the government's actions have largely unperformed expectations.

The forecast for the future points to a deeper and longer recession than those of the past twenty-five years, a recession that is synchronized around the globe. Within the United States, the Gross Domestic Product declined at an

annual rate of 0.3% in the fourth quarter, its second consecutive negative quarter. The unemployment rate is 7.2% and rising - the highest reading in over 15 years. The consumer has lost a significant portion of their net worth due to the collapse of the housing and stock markets.

Another real concern is deflation (falling prices). The issue with deflation is that consumers will forgo purchases today in anticipation of lower prices tomorrow, further depressing economic growth.

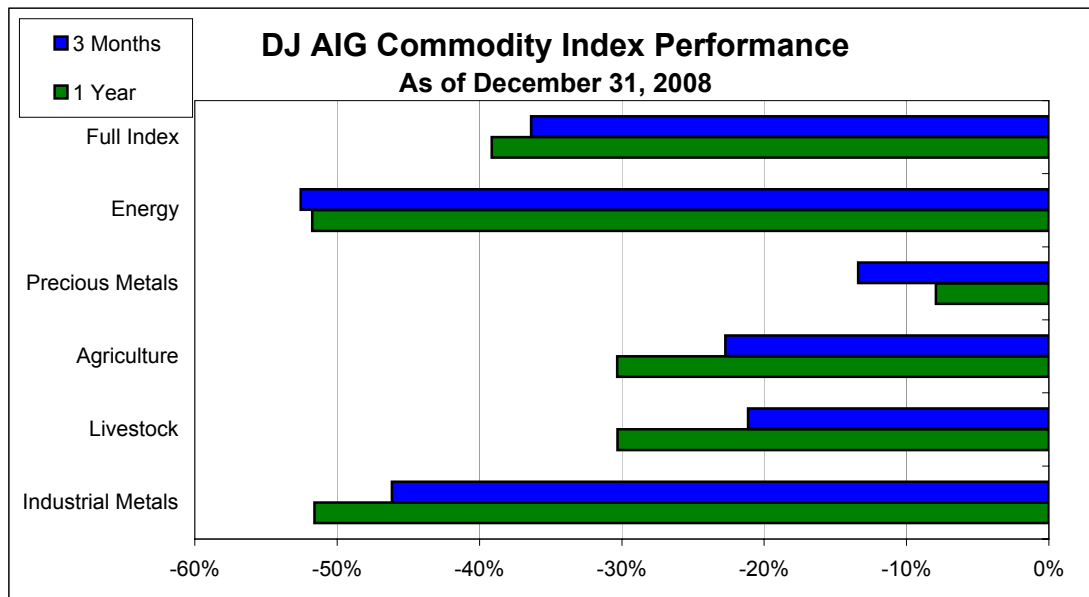
At present, we remain pessimistic about the capital markets and the economy. In our view, for a meaningful recovery to take place we need 1) a stabilization of the housing market to help restore consumer confidence and 2) a return to normal levels of liquidity and new issuance in the credit markets. One positive signal is the actions of the U.S. Government, which appears willing to continue extraordinary measures to alleviate the current issues.

In closing, we would like to commend you, our clients, for your patience and understanding during these very difficult times. We are committed to searching through these dysfunctional markets to uncover prudent investment opportunities for your Fund. Lastly, we would like to thank you for your continued support. We have exceptional clients and cherish our relationships with each and every one of you. As always, we welcome your questions and / or concerns.

Yours Truly,

Larry Gray and the Staff at Gray & Company

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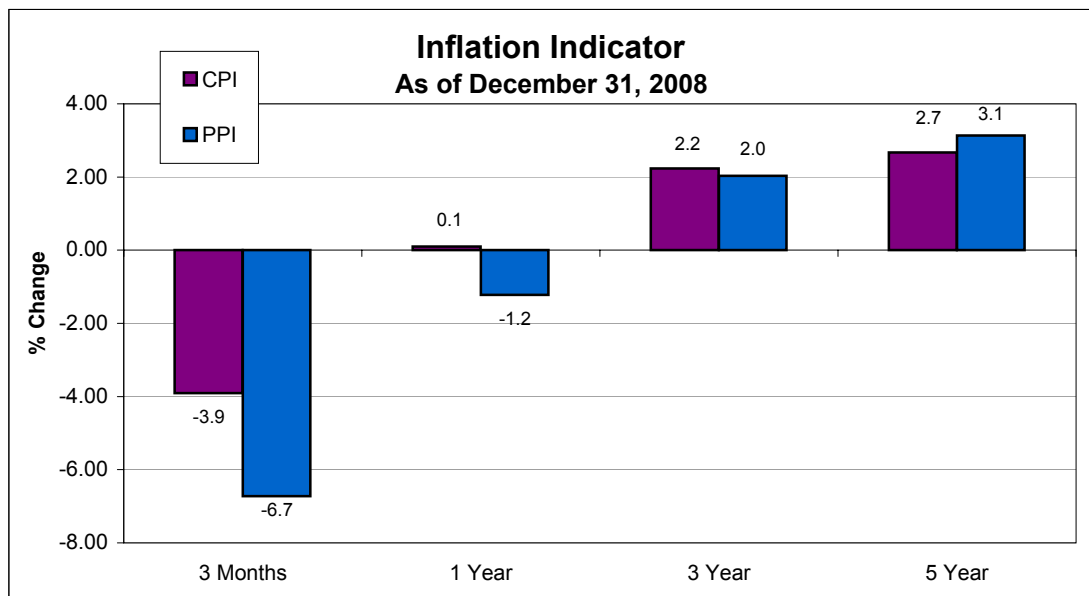


Back to Back: For the second consecutive quarter, the DJ AIG Commodity Index suffered its worst quarterly performance since its inception.

As of June 30, 2008, the DJ AIG Commodity Index was up over 35% for the trailing one-year. In the third quarter, the index was down 28% and down 35% this quarter. This sharp decline continues to be associated with the weakening demand for raw materials during the global economic slowdown.

Energy was the biggest loser again this quarter, falling an additional 50% after last quarter's 35% decline. The price of oil has fallen over \$100 a barrel from its peak six months ago. The other commodities also suffered significant losses, with all sub-categories ending the quarter and year with negative performance.

Deflation has replaced inflation as the primary risk to the global economy. The fear with deflation is that consumers will forgo current consumption in anticipation of lower prices in the future, further stunting economic growth. This quarter the CPI declined by nearly 4% and PPI was down over 6%.



Source: Bureau of Labor Statistics

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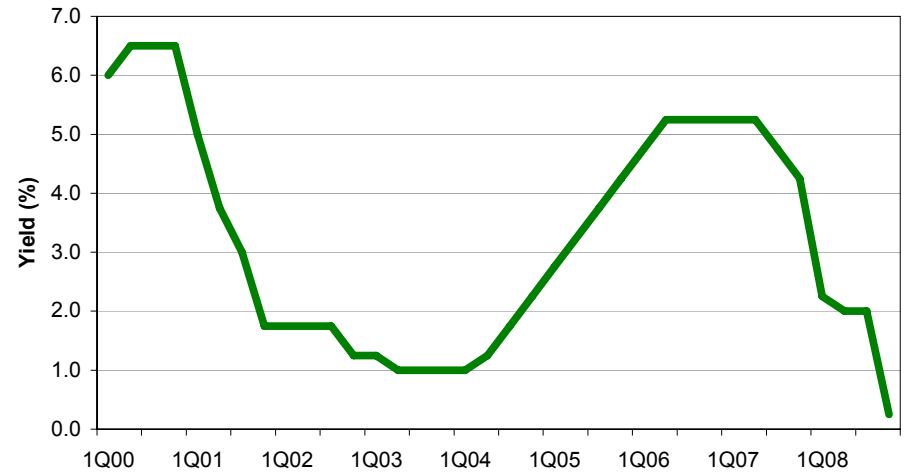
Fed Working Overtime: The Federal Reserve has been very busy coordinating their actions with the other government agencies. The Fed is attempting to stimulate the economy, stabilize the housing market, encourage risk taking, and protect against deflation.

The Federal Reserve cut the Fed Funds Rate seven times in 2008, reducing the rate from 4.25% at the start of the year to 0.25% in December. They indicated that rates may stay low for some time.

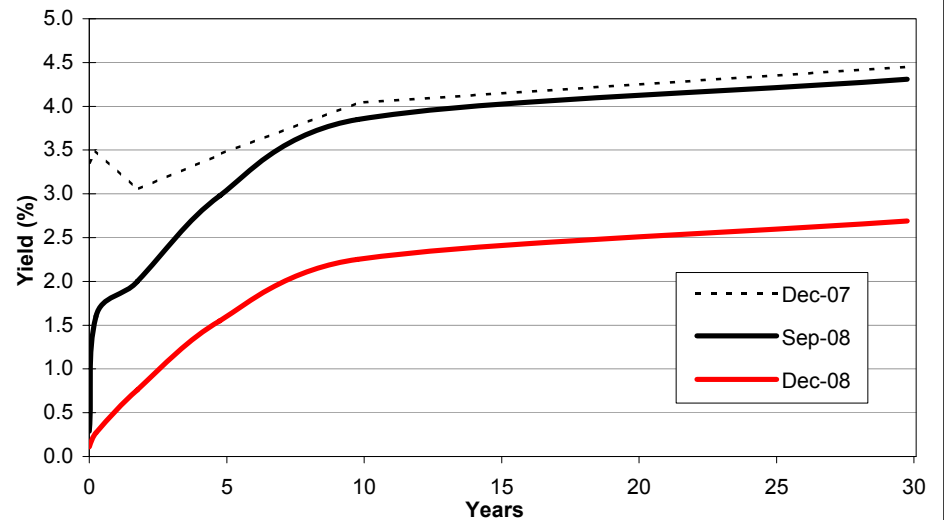
The Fed reiterated their plans to lower mortgage rates through the purchase of agency bonds and mortgage-backed securities. These initiatives are attempting to stabilize the housing market, one of the primary sources of the current crisis. The lower mortgage rates will help homeowners that have adjustable rate and traditional mortgages by reducing the reset rates or permitting them to refinance the property at a lower rate (provided they are able to qualify for a new mortgage). The lower rates will also encourage new homeowners into the market.

The combination of a risk-averse market and the Fed's actions has driven down the yield curve. The Federal Reserve hopes that the low yields on Treasuries will cause investors to search for higher return (riskier) options. In particular, they would like financial institutions to lend money to individuals and corporations. The lending will help restore liquidity to the credit markets and provide financing options to corporations and consumers.

Historical Fed Funds Rate



Yield Curve



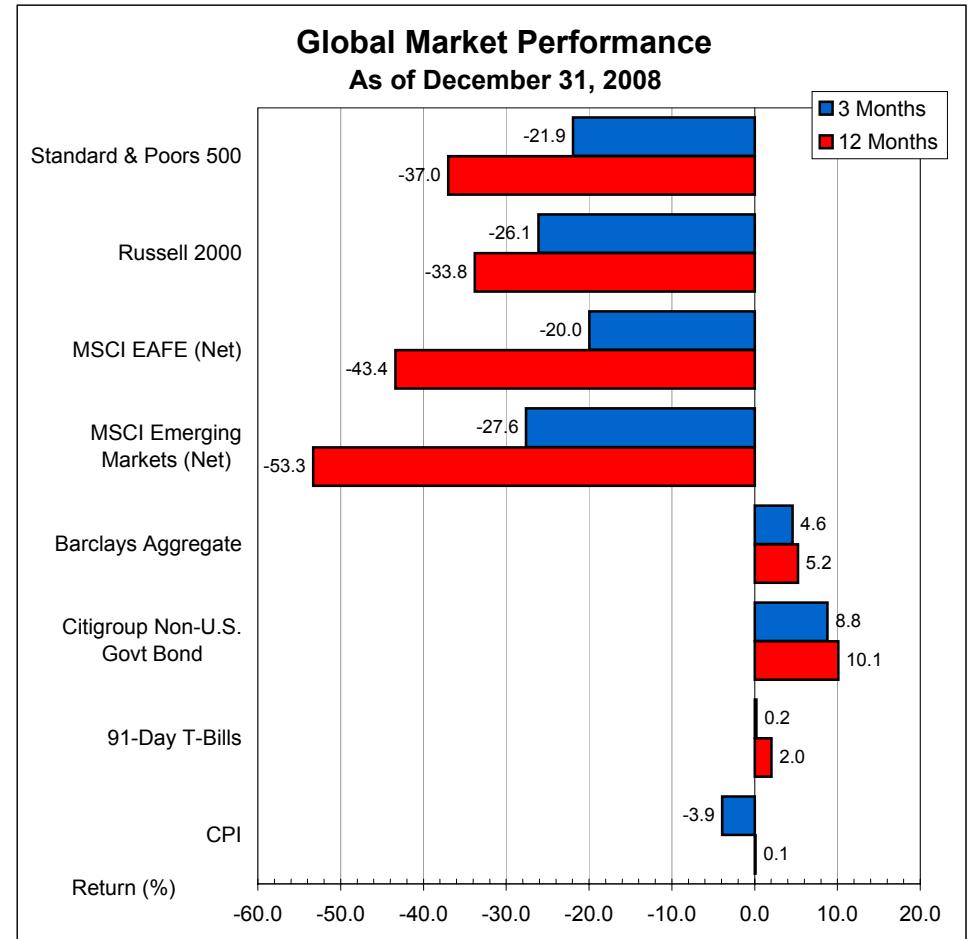
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The Good: Fixed income markets rallied strongly around the world. Unfortunately, that is about the only good news. The rally is based on the intervention of central banks as they attempt to solve the credit crisis and encourage economic growth and investors' preference for guaranteed assets. The spread sectors benefitted to a lesser extent from the declining interest rates, as spreads widened again.

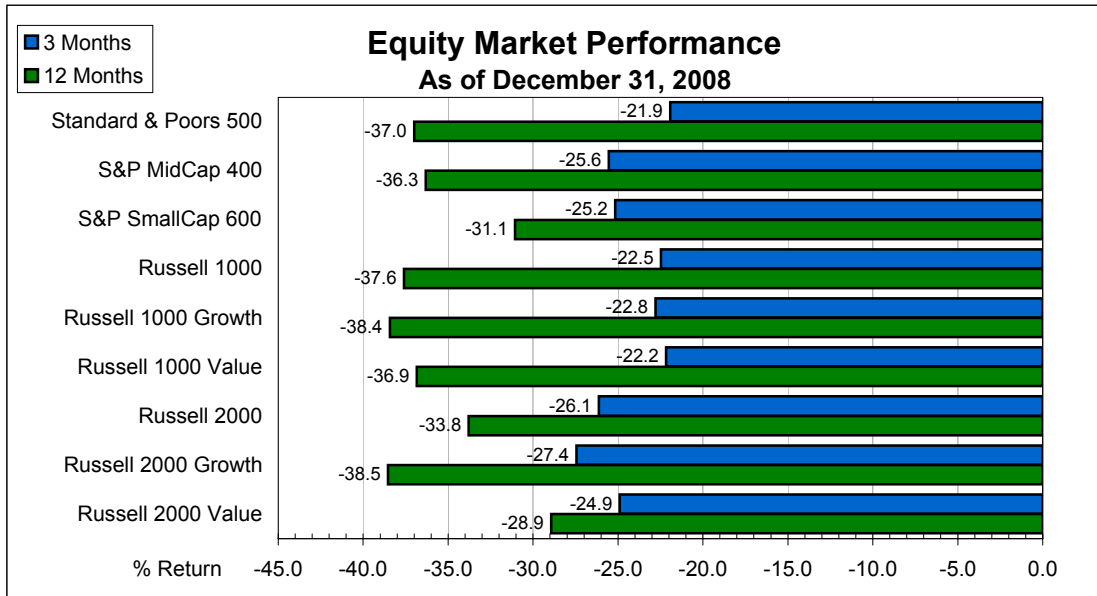
The Bad, and the Very Ugly: Equity markets collapsed by over 20% across the globe during the quarter and ended the year down over 30% (in some cases over 50%). The markets are reacting to the extraordinary deceleration in demand, continued impairment of financial assets, and the inability of firms to access the credit markets.

Diversifying portfolios into the international markets has not provided any benefits for U.S. investors. The correlations between domestic and international equity markets (and fixed income markets) have increased as countries become more dependent on the global economy and, particularly, during times of crisis. Currencies have been the main source of variance in performance.

Other asset classes have yet to fully realize significant losses. Real Estate's performance tends to lag due to the appraisal pricing process and longer-term leases. Private Equity will be impacted by the devaluation of equities, lowering expected returns and extending the maturity of the investments.



U.S. EQUITY MARKET

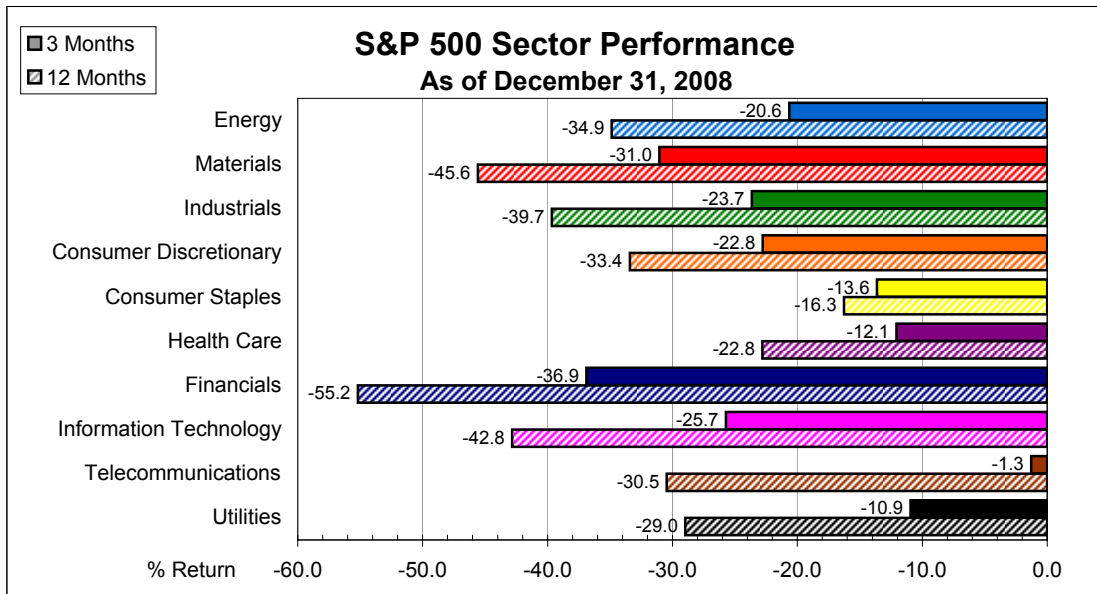


One for the Record Books: The Dow Industrials suffered their worst year since 1931, finishing the year down 33.8% (believe it or not, this was one of the better performing equity indexes). The NASDAQ was down over 40%, its worst year ever in its 38 year history, surpassing the -39% Tech-wreck of 2000.

The market set new lows in October and November before settling into a trading range in December. All cap ranges and styles were down an additional 20+% this quarter, with large caps slightly less negative than small caps. At this point there is very little good news to suggest a strong recovery is underway.

For the year, small caps out performed mid and large caps; small value was the only index not to lose over 30% for the year. Value lost less than growth across the capitalization range.

Financials led the markets in losses for the quarter and year, as the sector continues to struggle with deteriorating assets. The more recession-resistant Consumer Staples sector recorded the smallest declines for the year.



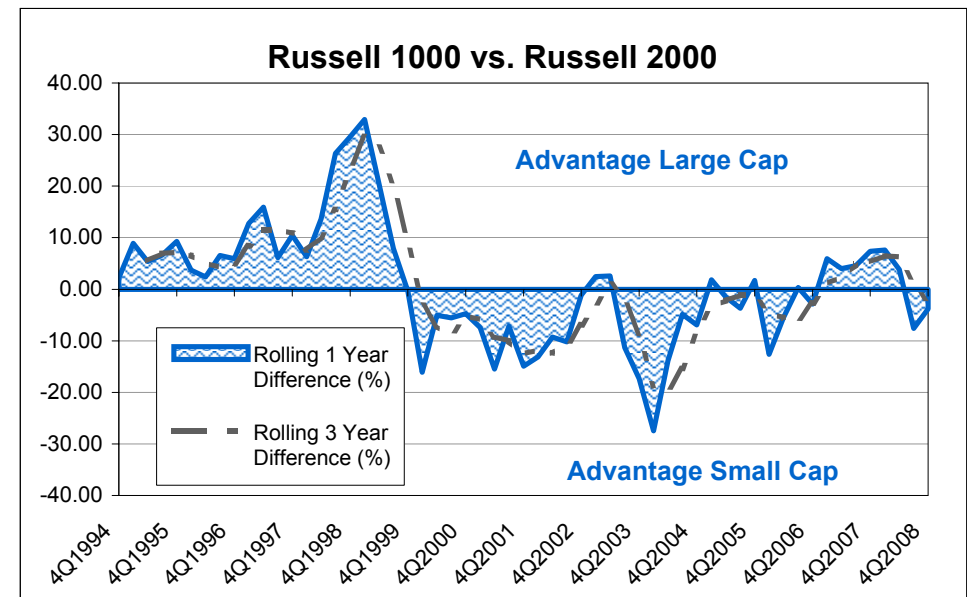
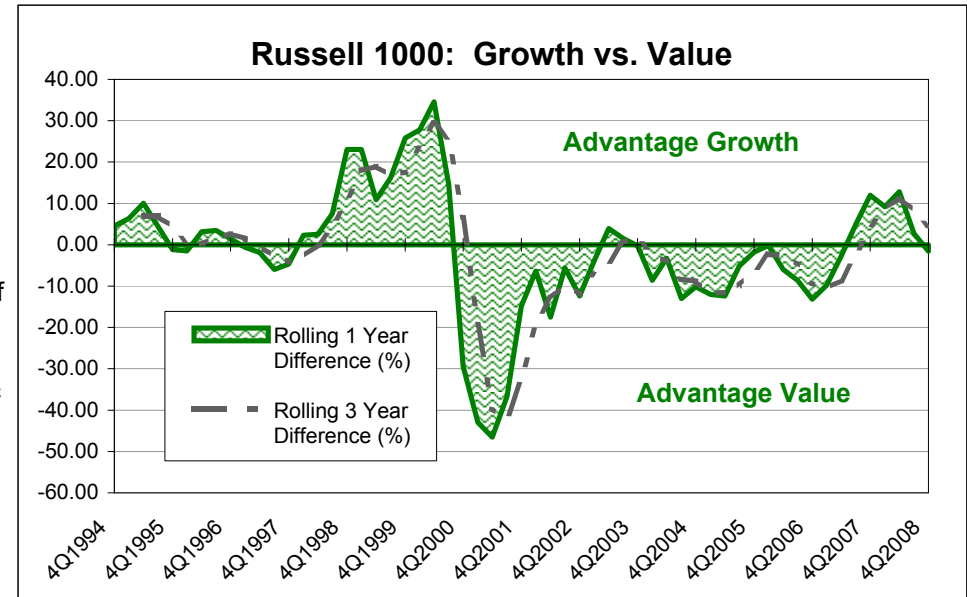
U.S. EQUITY MARKET

Reversal of Fortune: The continued collapse of the equity market has shifted the leadership of styles. Despite the poor performance from the Financial sector (a major component of value indices), Value still outperformed Growth over the past year, reversing a five quarter advantage for Growth.

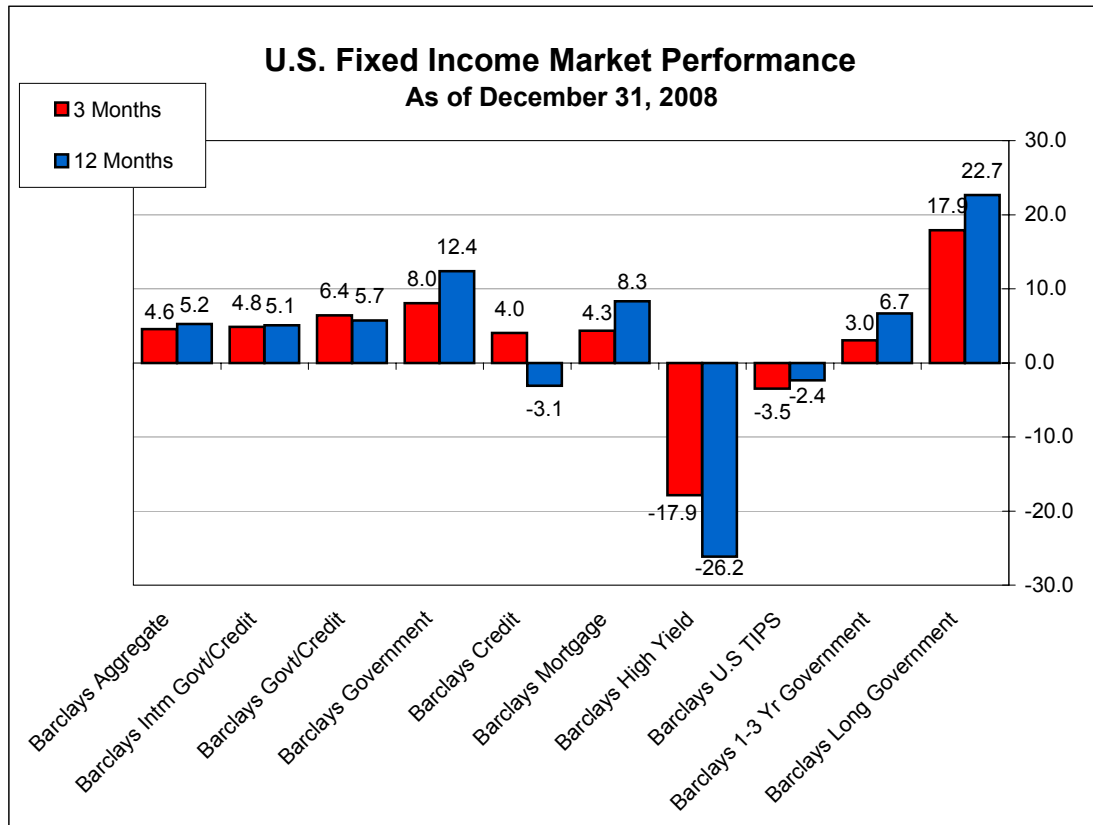
Interestingly, the style and capitalization shifts appear to be related. Value's out performance coincides with small cap's advantage. Small cap's rolling one-year return exceeded large cap for the second consecutive quarter. In prior periods, runs in value have been accompanied by the out performance of small cap equities. Growth equities and large cap equities have also experienced periods of out performance to their style/capitalization counterparts. These style and capitalization cycles are linked to the economic cycle. The different stages of the economic cycle produce favorable conditions for different sectors of the equity market.

The economic cycle entered the slowing/recessionary stage (favoring Health Care and Consumer Staples). As the economy recovers (early-recovery stage) the Industrials and Materials sectors will tend to out perform. The late-recovery stage (favoring Technology and Telecommunications) never gathered much momentum this past cycle. Energy and Financials are being influenced by factors independent of the current economic cycle.

The volatility theme of the past year continued this quarter. The Dow Industrials experienced two of its six best one-day percentage gains and four of its twenty worst one-day percentage losses in the last four months of 2008. This type of volatility tends to favor active trading strategies.



U.S. FIXED INCOME MARKET



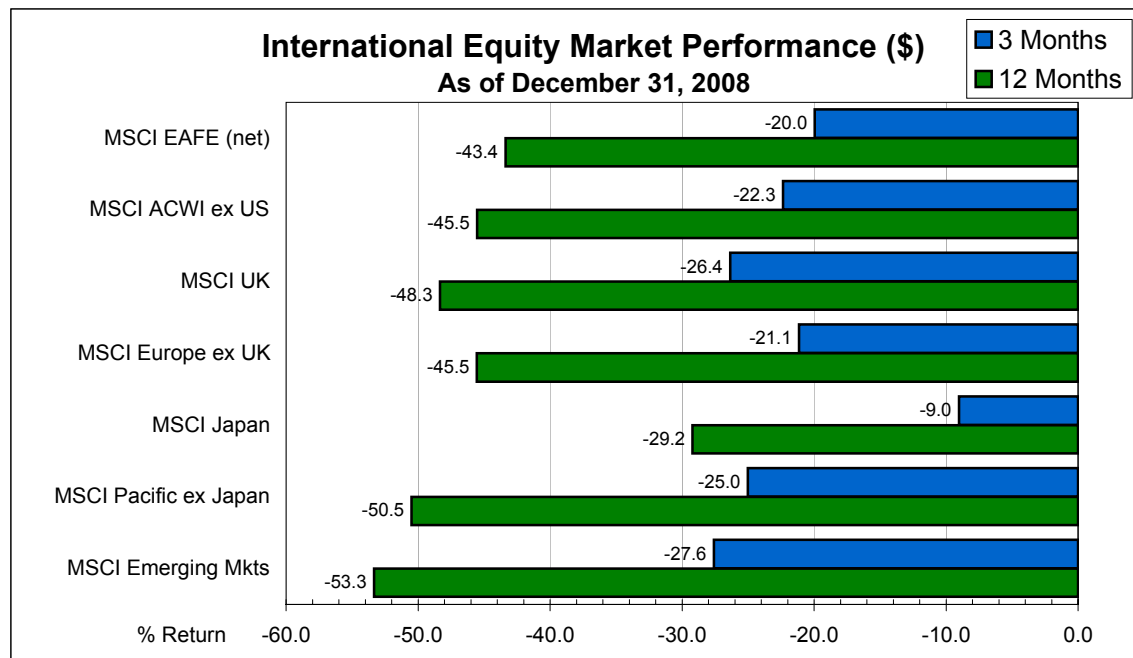
Safety + Liquidity = Treasuries: Despite the continued influence of the credit crisis, the fixed income market rallied. The Federal Reserve initiated several rate reducing programs and the yield curve shifted sharply downward across all maturities. Other programs of the Fed and Treasury have focused on the lack of liquidity in the market. These attempts have been less successful to date.

Treasuries were the best performing segment for the quarter and year, as investors sought the safety and liquidity of Government-backed issues. The yield on the 10 Year Note was 2.25% at year end. U.S. TIPS under performed due to the waning inflationary fears.

Mortgages had strong absolute returns for the quarter, however, significantly trailing Treasuries as spreads continued to widen. Corporates rallied in December to generate a 4% return for the quarter. However, the segment was negative for the year and under performed Treasuries by a record 15.5%. High Yield also suffered record losses during 2008. At year-end, spreads had widened to historic levels.

The fixed income market continues to face several related problems: 1) the weakness in the housing market (which serves as the underlying collateral for mortgage-backed securities), 2) the deterioration of balance sheets of many financial institutions, 3) the lack of liquidity within the credit market, 4) the lack of access to the credit markets for consumers and corporations, and 5) the slowing economy and the resulting reduction in consumer and corporate spending. The Treasury and Federal Reserve's responses to these crises have not always produced immediate results and additional time is required to fully assess their actions.

INTERNATIONAL EQUITY MARKET



MSCI Country Indexes (Net) Three Months Ending December 31, 2008

	Return US\$ (%)	Return Local Currency (%)	Currency Effect (%)
France	-20.3	-19.7	-0.6
Germany	-20.9	-20.1	-0.8
Italy	-23.1	-22.3	-0.8
Spain	-17.0	-16.1	-0.9
Switzerland	-13.3	-17.7	4.4
UK	-26.4	-8.7	-17.7
Europe Total	-22.8	-17.0	-5.8
Australia	-26.9	-17.2	-9.6
Hong Kong	-18.8	-18.9	0.1
Japan	-9.0	-22.3	13.3
Pacific Total	-13.9	-21.1	7.2
China	-10.8	-10.9	0.2
India	-29.9	-27.3	-2.6
Brazil	-37.3	-24.2	-13.1
Mexico	-30.0	-11.8	-18.2
Emerging Total	-27.6	-22.0	-5.6

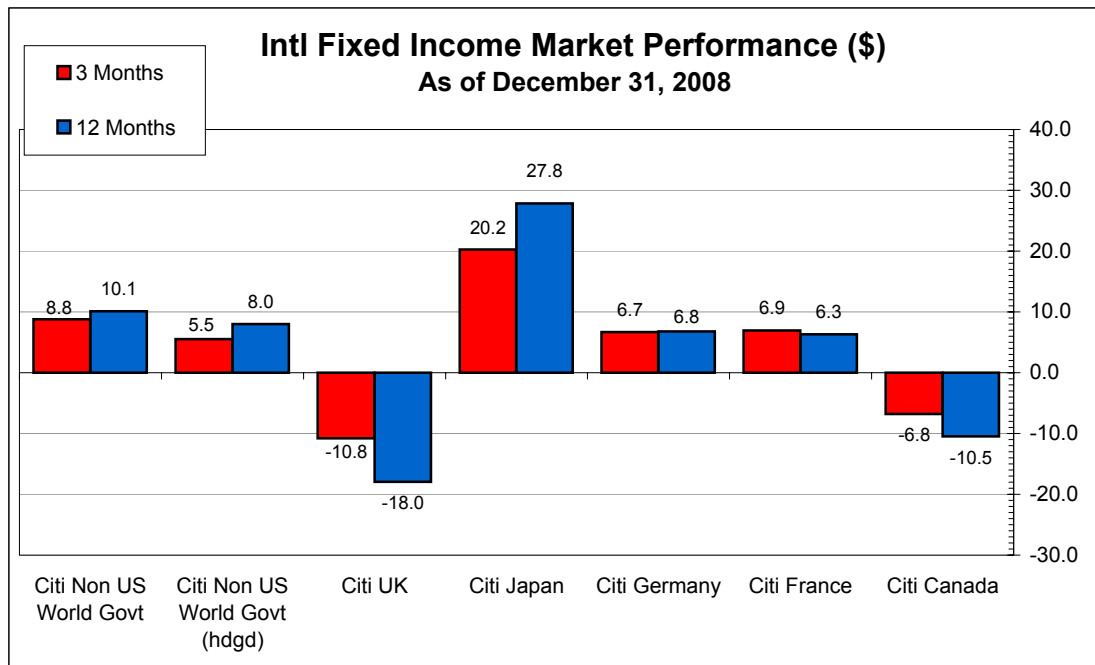
Global Credit Crisis, Global Recession, Global Crash: Economies around the world were impacted by the financial crisis and subsequent sudden decrease in U.S. consumption. Since the bankruptcy of Lehman Brothers in September, the global economy has been approaching recessionary status. The world's attention has shifted from inflation to deflation. Foreign governments have applied fiscal and monetary policies to help stabilize the markets and stimulate demand. However, the majority of the world equity markets declined by nearly 20% during the fourth quarter and 50% for the full year. 2008 marked the first year international stocks under performed the U.S. market in seven years.

The decline in the U.K. (in local terms) was relatively modest compared to the other developed markets. The Bank of England and the British government intervened in the markets, and the Pound weakened sharply against the Dollar and other currencies. In Euro-land, the equity markets suffered more significant losses while exchange rates ended the quarter nearly unchanged. The European Central Bank reversed their position and cut rates by 175 basis points during the quarter.

The Japanese equity market also suffered significant losses. Their export-oriented economy continued to struggle from the decline in global consumption and the strength of the currency. The Yen appreciated again as world-wide deleveraging spurred demand for the currency. The Bank of Japan lowered the target lending rate during the quarter and the government initiated a new stimulus plan.

The Emerging Markets were pummeled by the collapse of commodity prices, the decline in exports, the strength of the dollar, and the risk-averse nature of investors. These markets rebounded in December as the IMF offered aid, central banks lowered interest rates, and governments adopted stimulus package.

INTERNATIONAL BOND MARKET



Citigroup World Government Bond Indexes Three Months Ending December 31, 2008

	Return		
	Return US\$ (%)	Local Currency (%)	Currency Effect (%)
Austria	4.9	6.0	-1.1
Belgium	5.5	6.6	-1.1
Denmark	6.2	7.0	-0.9
France	6.9	8.1	-1.1
Germany	6.7	7.8	-1.1
Ireland	2.5	3.5	-1.1
Italy	2.6	3.7	-1.1
Netherlands	5.9	7.0	-1.1
Spain	5.6	6.7	-1.1
Sweden	-3.5	9.5	-12.9
Switzerland	9.1	3.5	5.5
UK	-10.8	10.6	-21.4
Europe Total	5.0	6.1	-1.1
Japan	20.2	2.7	17.6
Australia	-3.5	9.2	-12.7
Canada	-6.8	8.2	-15.0

INTERVENTION!: Governments and central banks have reacted to the credit crisis and global slow down with economic stimulus packages and sharp interest rate cuts. Spreads widened around the globe as investors sought safety over higher yields.

The European Central Bank and the Bank of London lowered interest rates and injected liquidity into the markets in an effort to spur economic growth and restore order to the credit markets. In the Euro-land markets, government bonds continued their third quarter rally into the fourth quarter with returns in the 6+% range in local terms. The marginally stronger dollar slightly hindered performance for U.S. investors. In the U.K., the returns were even more pronounced. Bonds gained over 10% in local terms. However, the Pound depreciated by over 20% in relation to the dollar (returns in \$ was -10.8%).

Currency was the story in Japan during the fourth quarter. The Yen appreciated against all major currencies as global investors were forced to deleverage their portfolios (a common investment theme for several years has been borrowing at the lower rates in Japan and investing in other countries with higher rates). The Bank of Japan managed to drop overnight rates slightly despite their already very low interest rates - and bond prices rose accordingly.

SELECTED INDEX RETURNS - PERIODS ENDING DECEMBER 31, 2008

	Quarter	One Year	Three Years	Five Years	Ten Years
US EQUITIES					
Dow Jones Industrial Average	(18.9) %	(31.8)	(4.0)	(1.1)	1.4
Standard & Poors 500	(21.9)	(37.0)	(8.3)	(2.2)	(1.4)
Russell 3000	(22.8)	(37.3)	(8.6)	(2.0)	(0.8)
S&P MidCap 400	(25.6)	(36.3)	(8.8)	(0.1)	4.5
Russell Mid-Cap	(27.3)	(41.5)	(10.7)	(0.7)	3.2
S&P SmallCap 600	(25.2)	(31.1)	(7.5)	0.9	5.2
Russell 2000	(26.1)	(33.8)	(8.3)	(0.9)	3.0
Growth Stocks - Russell 3000 Growth	(23.2)	(38.5)	(9.1)	(3.3)	(4.0)
Value Stocks - Russell 3000 Value	(22.4)	(36.3)	(8.3)	(0.7)	1.7
US FIXED INCOME					
Barclays Aggregate	4.6 %	5.2	5.5	4.7	5.6
Barclays Intm Govt/Credit	4.8	5.1	5.5	4.2	5.4
Barclays Govt/Credit	6.4	5.7	5.6	4.6	5.6
Barclays Government	8.0	12.4	8.1	6.1	6.2
Barclays Credit	4.0	(3.1)	2.0	2.7	4.9
Barclays Mortgage	4.3	8.3	6.8	5.5	6.0
Barclays High Yield	(17.9)	(26.2)	(5.6)	(0.8)	2.2
Barclays U.S TIPS	(3.5)	(2.4)	3.1	4.1	6.8
Barclays 1-3 Yr Government	3.0	6.7	6.0	4.1	4.8
Barclays Long Government	17.9	22.7	11.2	9.6	8.1
INTERNATIONAL (Measured in US Dollars)					
MSCI EAFE (Net)	(20.0) %	(43.4)	(7.4)	1.7	0.8
MSCI ACWI ex U.S. (Net)	(22.3)	(45.5)	(7.0)	2.6	n/a
MSCI Europe (Net)	(22.8)	(46.4)	(6.6)	1.5	0.4
MSCI Pacific (Net)	(13.9)	(36.4)	(9.1)	1.9	1.9
MSCI Emerging Markets (Net)	(27.6)	(53.3)	(4.9)	7.7	9.0
Citigroup Non-U.S. Govt Bond	8.8	10.1	9.5	6.0	5.6
REAL ESTATE					
NAREIT Index	(36.6) %	(37.3)	(11.6)	(0.5)	6.7
NCREIF Property Index	n/a	n/a	n/a	n/a	n/a
OTHER					
91-Day T-Bills	0.2 %	2.0	4.0	3.3	3.5
Consumer Price Index (percent change)	(3.9)	0.1	2.2	2.7	2.5
Producer Price Index (percent change)	(6.7)	(1.2)	2.0	3.1	2.6

Note: Returns for periods longer than 12 months are annualized.