



Fourth Quarter 2008 Market Analysis and Outlook

Dear Client:

Stock market losses during this period made third quarter losses look tame. The S&P 500 Index fell 21.9% and the Dow Jones Industrial Average Index fell 19.1% in the fourth quarter alone. Morningstar's US Market Index plunged nearly 23%; down 37% for the year. The declines were even greater for domestic mid cap growth stocks with Morningstar's Mid Cap Growth Index posting a loss of 46% for the year. Foreign stock markets did not fare any better. The Hang Seng Index of Hong Kong fell 20%, the Chinese Shanghai Index fell 21%, the French CAC-40 Index fell 20% and the Latin American market fell 33% during fourth quarter 2008. ***What caused these massive declines in the markets?***

Credit markets froze, stifling business activity and stoking fears of major failure throughout the financial system. Businesses couldn't access the short-term capital they've relied on for decades to fund normal business operations, which threatened severe damage to the economy. In October, fear intensified as investors began to realize how negatively deleveraging (reducing debt) would affect economic and corporate earnings growth, even if they could avoid collapse of large portions of the global financial system. This led to a massive selloff in every asset perceived to have any risk. Consequently, governments worldwide have taken action to restore confidence in the credit markets.

In the current selloff environment, there was no place to hide. Every asset class (with the exception of U.S. Treasury securities) fell. In addition, huge deleveraging by hedge funds triggered massive selling that caused many stocks and bonds to perform out of line with their fundamentals. We believe this explains the underperformance of many of our money managers (and suggests it could reverse). Even asset classes that had bolstered our portfolios during the first half of 2008, namely commodities and energy, plunged during this period. Oil went from over \$140 per barrel to less than \$40. The Morningstar Long-Only Commodity Index fell 31% in fourth quarter, ending 2008 down 34%. Fearful investors dumped consumer services and health care stocks to a lesser degree than other sectors, but even these sectors posted losses of 26.55% and 23.18, respectively, for the year.

According to the National Bureau of Economic Research, the U.S. recession began in December 2007, making this one of the longest recessions in recent times. Most economists believe the economy will contract further in 2009, unemployment will increase and consumer spending will decrease. With the S&P 500 index having dropped by more than 50% (in real terms) from its previous highs, the question is whether the massive price declines have already discounted all the bad economic news and hence laid the foundation for a significant rally. Those who argue that a rally is likely in the latter of 2009, cite governments' unprecedented steps to protect economic growth using both monetary and fiscal policies.

Moving forward, we see a number of areas that look attractive. We believe that some losses in stock prices were not justified, with prices falling too far, even after accounting for worsening fundamentals. We believe stocks are relatively cheap now, even after accounting for a negative earnings environment. This happens when fear and pessimism overwhelm fundamentals, and this is what creates longer-term opportunities. Further, we continue to identify individual stocks that are unevenly valued. As previously stated, hedge funds (forced to raise cash) were major sellers of stocks causing many stocks to perform inconsistently with their fundamentals.

Other asset classes are also getting attractive, and we will continue to see tactical opportunities that we hope will further improve our returns going forward. For example, real estate investment trusts are beginning to look attractive after a huge selloff, and even assuming major declines in their underlying property values, they are



priced to deliver good returns. Longer term, we believe there are reasons to be bullish on commodities. We believe, for example, that the proposed economic stimulus plans that will fund large infrastructure projects should eventually bolster market demand for several commodities. At a time like this, rebalancing will be a critical factor in a portfolio's long term performance.

We share the frustration that comes with poor performance and losing money. This has been the most difficult stretch of performance in our and our money managers' careers. During the bursting of the tech bubble and the subsequent bear market, we outperformed by a large amount across all of our strategies. Moving forward, we are focused on identifying and taking advantage of opportunities available to us. It's important to remember that markets do have floors. It's when they seem like they don't that a bottom is typically reached. At this point of maximum pessimism: all sellers have sold, and with no more sellers, the market rebounds.

Where do we go from here? Assuming a subpar recovery to the current recession, we believe that conditions are in place for a sizable rally following recent steep losses. But, as always, we can't predict the short term market behavior other than to guess we'll continue to see lots of volatility. In addition, the markets will not be able to sustain an advance until the credit system starts to function more normally and there are signs that leading economic indicators are bottoming.

The historic losses of 2008 have highlighted the importance of honestly evaluating one's risk tolerance. As we begin year 2009, this is a good time to reevaluate your risk tolerance. If, after considering your time horizon and how much access to capital you'll need over the next five years, you believe further declines would force you to make changes to your lifestyle then switching to a more conservative strategy may be necessary. Keep in mind though that it's generally not a good idea to change your risk tolerance this far into a decline; doing so may reduce the returns you should expect going forward. In the end, you must decide whether you can handle more risk in the short term.

As we've said in previous commentaries, market bottoms almost always come before the bottom in the economy. If clients get overly conservative this far into a decline, they risk missing a significant part of the longer term upside potential should stocks rebound sharply after reaching a bottom. When stocks begin to rebound, it may be psychologically difficult to buy in at levels higher than where you sold. Fear of a sucker rally can be hard to overcome. Should stocks move higher still, it becomes even harder to pull the trigger.

We believe it doesn't make sense to become more conservative now. However, only you can decide how much risk you can handle and whether you can stay invested long enough to potentially earn decent long-term returns in the event of further near term declines. Of course, your investment adviser representative can assist you. Please call us at **888-862-9923** to schedule your annual account review, discuss any changes to your financial situation or for any financial planning advice you may need. We appreciate your business and look forward to a more promising 2009.

Sincerely,

Jamal Elbarmil
February 4, 2009

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