Investment Report And Market Commentary

BRAGG FINANCIAL ADVISORS

Fourth Quarter 2008

Dear Friends,

You have heard from us with greater frequency over the last three months as markets have tumbled and the financial crisis has worsened. As I prepared to write this letter, I went back and did an inventory of our last five communiqués. Here they are in chronological order:

9/23 Audio File— "Dow off 22% since peak and Congress authorizing $700 billion bailout…Don't abandon long term investment plan."

9/30 Quarterly Commentary— "What caused this crisis: failure of Congress to rein in Fannie and Freddie, low interest rates, greed/profit incentive, leverage, failed regulation, rating agencies and borrowers. Getting up the hay on Bragg farm..."

10/09 Special Market Commentary— "Market off 36% from peak...How can our financial system freeze up? Massive selling to generate cash leads to credit crisis. Hesitant to sell our stocks at these prices...I am not selling my house at this price just because I have received a lowball offer."

10/31 Special Market Commentary— "Your October statement will be in your mailbox soon and it will not look good. S&P off 42% from peak...history of bear markets...past recessions...Bragg nevertheless thriving...a word of thanks..."

12/19 Special Market Commentary— "No exposure to Madoff...Pershing's strength...your money is safe."

We hope our frequent efforts to share our thoughts with you have been helpful through these historic and yes, frightening times. Please visit our website at www.braggfinancial.com and click on Quarterly Investment Reports to review any of these commentaries.

My father is fond of telling prospective clients that we will do a better job than our competitors because **"we worry more about our clients."** Dad's assertion is unusual but it is sincere; we truly are concerned for the well-being of our clients. We take our responsibility as your advisor very seriously and the events of the last three months have been extremely disappointing. We've had a historic opportunity to do some worrying. Anxiety on steroids! The silver lining of this challenging environment has been that it has given us the opportunity to work closely with so many of you. Our relationships with you give great meaning to our work and we feel very fortunate to have you as clients.

There is no denying the severity of the downturn gripping the global economy. Undoubtedly 2009 will be a difficult year. Even as governments across the world serve up huge spending packages to stimulate their economies, the negative headlines will continue for some time. We'll learn of massive job losses, personal and corporate bankruptcies, home prices falling even further, growing government debt and corporate earnings declines. And yet, like the ten recessions of the last half century, this one will end at some point and the economy will begin to expand again. Buckle in and we'll make it through. As Winston Churchill once said, **"When you are going through hell, keep going."**

You may have heard the expression, "The market climbs a wall of worry." This was certainly the case between the market low of November 21st and the end of 2008. More bad economic news was crammed into that six-week period than I have heard in my 18-year career in the financial business. Headlines included the worst monthly job loss in 34 years, automakers on their knees before Congress begging for a bailout, consumer confidence at an all-time low, rising unemployment, massive layoffs, the Madoff Ponzi scheme, the threat of deflation, the threat of inflation and on and on. **And yet, the S&P 500 gained 22% during that six week period.** How could it possibly do that? There was no good news...none! The only answer I can offer is that the market is a leading indicator; it is looking to the future while we humans are fixated on the bad news of today and yesterday. Now the fact that the market is up 22% since its low does not mean that the worst is necessarily behind us. As always, we should tell ourselves that it will get worse before it gets better and then hope to be pleasantly surprised.

A bright spot in an otherwise dismal fourth quarter was the performance of our own Queens Road Small Cap Value Fund. On January 5th, the Wall Street Journal included our fund in their 2008 "Category Kings" listing of the best performing small cap funds in the country. We are proud of Steve Scruggs, CFA, portfolio manager of this fund.

On the next page you'll find the 2008 numbers, some insight on past recessions and finally some encouragement for the future.

We hope 2009 is a great year for you and your loved ones. As always, thank you for choosing Bragg to help you with your planning and investing.

Sincerely,

Benton S. Bragg

Benton S. Bragg, CFP, CFA
President, Bragg Financial Advisors, Inc

BRAGG FINANCIAL ADVISORS

2008 Market Recap

As mentioned on the previous page, the S&P 500 is up 22% since its intra-day low of 741 reached on November 21, 2008. While this is encouraging, there is no getting around the fact that 2008 was one of the worst years in market history. On a price basis, the Dow was down 34%, the S&P was down 38%, foreign developed markets were down 44% and emerging markets were down 54%. The table below paints a devastating picture of worldwide wealth destruction.

Global Wealth Destruction (Equity Market Returns)

Country	2008 Return	Country	2008 Return
US	-37.6%	Japan	-29.2%
Canada	-45.5	Singapore	-47.4
UK	-48.3	Australia	-50.7
Austria	-68.4	Hong Kong	-51.2
Belgium	-66.5	Egypt	-52.4
France	-43.3	China	-50.8
Germany	-45.9	India	-64.6
Spain	-40.6	Indonesia	-56.5
Ireland	-71.9	Korea	-55.3
Portugal	-52.2	Taiwan	-46.5
Russia	-73.9	Mexico	-42.9
Hungary	-61.5	Brazil	-56.2
Poland	-54.8	Argentina	-54.5
Turkey	-62.3	Peru	-40.2

Equity Market Returns Shown in US Currency. Source: MSCI BARRA

Equity returns around the globe were bad, but so were returns for most other financial and hard assets like commodities. With the exception of US treasury bonds, cash and gold, there were simply very few places to hide in 2008.

Few Places to Hide

Index	2008 Return	Index	2008 Return
US Treasury Bond	13.7%	Real Estate (MSCI)	-38.0%
Corporate Bond	-3.1	DJ-AIG Commodities	-36.6
High Yield US Corp.	-26.2	Gold (S&P GS)	3.9
US Treasury Infl. Prot	-2.4	Silver (S&P GS)	-25.4
Muni Bond	-2.5	Platinum (S&P GS)	-38.2
Global Corporate	-8.7	Crude Oil	-53.5
Emerging Mkts Bond	-14.8	Natural Gas	-24.8

Bond Returns Provided by Lehman (Barclays)

As we have pointed out in past commentaries, this market decline from peak to trough is worse than the two major declines experienced since the Depression. Both the decline of 1973-1974 and the decline of 2000-2002 saw the stock market drop about 45%. **From its high on October 9, 2007 to the trough reached on November 20 of 2008, the S&P 500 was down 52% (price).** As mentioned in the opening paragraph, we are already well off the low of November...hopefully that low will hold.

Recessions, Markets and History

On December 1, 2008 the National Bureau of Economic Research surprised no one when it finally announced that the US economy was in recession. The last business cycle peaked in December of 2007, meaning we have already been in recession for over a year. Of the ten recessions we have endured since WWII, the average duration is eleven months. The table below compares the current recession to past recessions.

Most indicators point to this being a relatively severe recession. Debt-laden consumers are finding they can't access credit, their home equity has evaporated, their stock portfolios are down 50% and some worry about losing their jobs. As consumer spending makes up 70% of our economic output, these developments are problematic. The government is working hard to make up the difference through the combination of monetary policy (lowering the cost to borrow) and fiscal policy (tax breaks, tax credits and massive government spending). It is estimated that the federal deficit will exceed one trillion dollars in 2009 and 2010 (that will be the subject of a future newsletter). This record amount of liquidity flooding the system in coming months should begin to stimulate the economy in 2009, but the timing of a turnaround is uncertain.

Date of Recession	Duration (Months)	Unemployment (Peak)	GDP Decline %
Dec. 2007- present	**13 and counting**	**7.2 current**	**-0.5% so far**
March 2001	8	5.5	-0.30
July 1990	8	6.8	-1.5
July 1981	16	10.8	-3.6
Jan. 1980	6	7.8	-1.1
Nov. 1973	16	8.8	-3.6
Dec. 1969	11	5.5	-0.8
April 1960	10	6.9	-2.4
Aug. 1957	8	6.2	-3.3
July 1953	10	2.9	-2.2
Nov. 1948	11	5.9	-1.1
Average	**10.6 months**	**6.70%**	**-1.9%**

Inflation concerns are dormant for now with wage pressure down and once-soaring commodities prices now a non-issue. Oil alone has fallen over 70% from its peak of $147 per barrel to around $40 at year-end. At some point, however, the inflationary impact of the fiscal and monetary stimulus will again have the Fed playing a delicate balancing act between stimulating growth and staving off inflation with higher interest rates.

If history is any guide, the market will bottom and turn up long before the recession ends. Planning to get into the market once the "headlines are good and the recession is over" will guarantee that you miss the bottom and the nice bounce that follows. Having said that, **it will likely take years for the market to reach the high of October 2007.** Some might therefore conclude that the stock market is not a good place to store our wealth today. We feel strongly that this is the *wrong* conclusion. Importantly, if the market got back to its high over the next five years, we would earn a very acceptable 12% per year. With CDs and government bonds yielding 2.5% today, we think stocks are quite attractive for long term investors.