Investment Report And Market Commentary

BRAGG FINANCIAL ADVISORS

First Quarter 2009

Dear Clients,

It's amazing how much better you feel with a little sunshine and a few good weeks in the stock market. Dogwood, cherry and redbud blossoms have been particularly welcome sights this year after a winter of rain, cold, plunging stocks and a deep recession. Toss in some March Madness and suddenly I don't know why I was so down in the dumps last month. I might as well go ahead and quote my father and say, "Life is good and getting better."

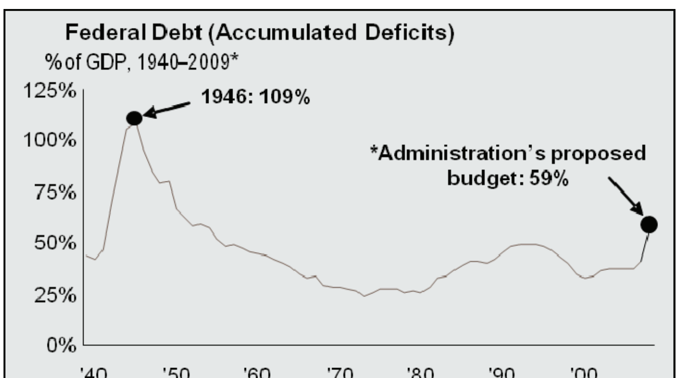
Perhaps that is a bit too much in the category of "the glass is half full" at this stage of the game. We certainly have a rough road ahead; you'd have to be really tuned out not to realize that, but I for one am enjoying a brief respite from the steady drumbeat of negativity we've had to endure of late. I hope you are too.

By the time our next quarterly report is mailed out, Bragg Financial should be settled into our new offices. In case you haven't heard, we have built a new building at the corner of Lexington and South Caldwell, adjacent to the Dowd YMCA. We will be moving next month and we are very excited about our new home. We will gain some much needed additional space and our client meeting areas will be outfitted with the latest technology to make your visits to Bragg comfortable and efficient. We look forward to your visit at our new home.

The next sections of this report include our thoughts regarding the economy, the markets and how we are managing portfolios during this uncertain time. As always, thank you for choosing Bragg Financial to help you with your planning and investing. Please let us know when you would like to review your accounts or your financial planning.

Sincerely,

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



Source: Congressional Budget Office, St. Louis Fed, Bureau of Economic Analysis, JPMorgan Asset Management. Data reflects most recently available as of 03/31/09. Note: years shown are fiscal years (Oct. 1 through Sep. 30). Chart displays federal debt in the hands of the public.

Economy: Tar Heel basketball, cherry trees and sunshine notwithstanding, our economy is still mired in a deep ditch and many challenges remain. Our gross domestic product likely declined again in the first quarter of 2009 following the biggest drop in 26 years in the fourth quarter of last year. The unemployment rate hit 8.5% recently as the labor department announced that we lost 663,000 jobs in the month of March, following similar losses in the months of January and February. This is the highest rate of unemployment since 1983. This recession will likely match the severity of the recessions of 1973 and 1981 in terms of duration and unemployment.

While the housing crisis and the near failure of our banking system led us into this recession, the sharp drop in consumer spending has exacerbated the decline. As in most economic contractions, employers of all types are feeling the pinch and have moved to eliminate jobs to reduce their expenses. This of course creates a vicious cycle, as workers, either unemployed or worried about being unemployed, increase savings and further reduce their spending. As you are well aware, the federal government has stepped in to fill the void, aggressively pumping money into our insolvent financial system while simultaneously passing record spending bills designed to both prop up the most vulnerable in society and also to put a floor under demand.

The government spending solution may work; we certainly hope it will. But this solution obviously has its own risks, the biggest of which is how to pay for it all. The short-term solution is to borrow more money and the chart above from the Congressional Budget office makes it clear that our nation's debt as a percentage of gross domestic product is going to rise dramatically.

Our ability to eventually repay this debt is dependent on an economic recovery that generates higher tax revenues. So we are in a tough situation. Importantly, we have been here before. In the seventies we faced soaring energy prices, inflation, war and political turmoil. In the early eighties the prime rate reached 21% (today prime is at 3.25%). Every

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crisis is different but we feel confident that with time, we will move past this one too.

So the economy is in bad shape and that is why the stock market is down 50%. This is an important point. One might conclude that with such a bleak economic outlook, we would be wise to avoid risky assets like stocks, real estate and corporate bonds. But today's much lower market prices likely already reflect the bad news we just discussed. History has shown that often a good time to invest is when things look especially bleak. To paraphrase Warren Buffett, "Be greedy when others are fearful." Will our timing be exactly right? Probably not...it is going to be extremely hard to call a bottom. We should tell ourselves that the economic news will worsen and that the prices of risky assets will fall further before turning up again. We will be okay as long as we can stay the course.

Liquidity First: Before talking about long-term investment opportunities, we think it makes sense to think about the downside risks that remain. Make sure you are in a position of sustainability. If you are retired or nearing retirement, we would suggest that you have as much as ten years worth of spending in bonds and cash. We have often written about the fact that the market often takes much longer to adjust than we would expect. Cycles take time and the market usually overdoes it on the downside just as it overdoes it on the upside. We may have seen a bottom with this market on March 9 but this may be another "bear market rally" as they say. We certainly do not know what the market will do in the short-term but we think it is prudent to always be positioned so you are not forced to sell stocks when they are down.

Here are the returns for various indices for the period ending March 31, 2009.

Market Index	YTD 3/31/2009	1 Year	3-Year Annualized	5-Year Annualized
Standard & Poor's 500 (Large Cap)	-11.0	-38.1	-13.1	-4.8
Standard & Poor's 400 (Mid Cap)	-8.7	-36.1	-13.6	-2.8
Russell 2000 (Small Cap)	-14.9	-37.5	-16.8	-5.2
MSCI EAFE (Foreign)	-13.9	-46.5	-14.5	-2.2
Barclays Lehman Aggregate Bond	0.12	3.1	5.8	4.1
Barclays Lehman Municipal Bond	4.2	2.3	3.2	3.2

Fixed Income: While the last twelve months were difficult for many parts of the bond market, the decline pales in comparison to the decline in stocks. An often used description of the recent market decline is "there has been nowhere to hide." In fact, bonds have basically done the job we would expect within a diversified portfolio. We own the bonds for stability and income and generally they have provided that over the past year, especially when compared to other asset classes like stocks or real estate. The following table shows you the twelve-month return of various bond indices. It also lists the current yields for these instruments. Nowhere is the risk/reward relationship more clearly demonstrated than in a comparison of bond yields. The "safest" instruments have the lowest yields while the "riskier" instruments offer much higher yields. Said another way, you get paid to take risk. You can see that treasuries, while offering the guarantee of the federal government also offer the lowest yields while high-yield corporate bonds (often referred to as "junk bonds") offer very high yields reflecting the much higher risk of default. Finally, tax-free municipals today offer extremely high relative yields reflecting the risk that many states and other municipalities will not be able to service their debt as a result of declining tax revenues.

Fixed Income Instruments 4/06/09	Return Last 12 Months	Current Yield
Lehman 1-3 Year Treasury	3.8	0.9
Lehman 7-10 Year Treasury	9.3	2.8
Lehman Inflation Protected	-2.0	1.8
Lehman Municipal	2.4	4.1
Lehman Corporate	-5.2	7.1
Lehman High Yield Corporate	-18.9	17.7

We wrote earlier about the significant increase in our federal government debt. Historically, an increase in debt such as this has been inflationary, reducing the purchasing power of our currency. Treasury Inflation Protected Securities (TIPS) offer a return in the form of a coupon plus an annual adjustment equal to the change in the Consumer Price Index. While it seems like an easy decision to load up on these bonds, the annual adjustment becomes a *downward* adjustment to the extent we have deflation like we have experienced over the last 12 months. It's a two–way street and we need to keep that in mind. Assuming we do see inflation in the years ahead, these securities offer a hedge and are an important part of our diversified fixed income portfolio.

If the economy continues to weaken and the stock market declines again, treasuries will likely outperform corporate bonds, TIPS and municipals. If on the other hand, the economy has bottomed and we continue to see signs of life (as we have here lately) then corporate bonds, TIPS and municipals will be the big winner and treasuries will actually see a decline in price. Not knowing what the future holds, we continue to own a diversified portfolio that includes exposure to each of these types of instruments.

Stocks: While we have enjoyed a nice market rally over the last few weeks, the S&P 500 ended the first quarter down 11% since the end of 2008 and down almost 50% since its peak reached in October of 2007.

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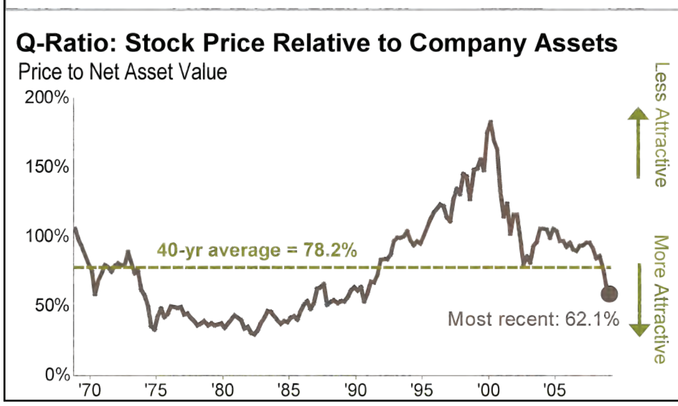
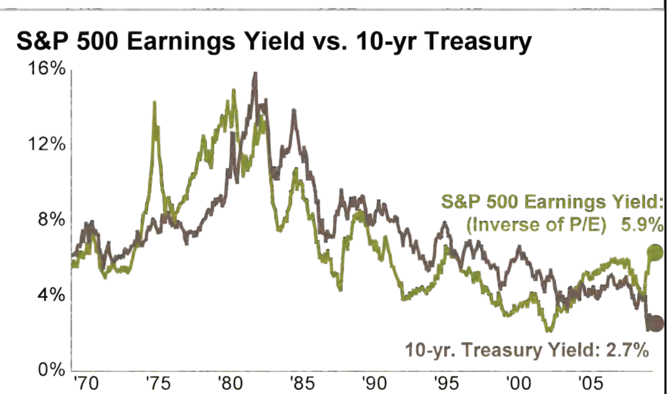
The price movement of the S&P 500 in the chart below forms an almost perfect "M-shape" in its movement from year-end 1996 through its close last week. In this case, **"M" is for misery** as the S&P doubled from December 1996 through March of 2000 and then lost 50% to bottom in October of 2002, then doubled again through October of 2007 and now has fallen back close to the level of 1996. It has been a frustrating and disappointing twelve years for us all.

Are stocks a good investment today? Based on historical measures, you can certainly make the case for stocks at these prices. The following charts and tables provided by JP Morgan show various valuation measures for the market and each indicates that the market represents a relatively good value today compared to past periods.

S&P 500 Index: Valuation Measures

Valuation Measure	Description	Latest	1-year ago	Historical Averages: 3-year avg.	5-year avg.	10-year avg.	15-year avg.	20-year avg.
P/E	Price to Earnings	16.9x	21.4	18.9	19.0	24.8	23.6	22.5
P/B	Price to Book	1.5x	2.5	2.6	2.7	3.3	3.3	3.1
P/FCF	Price to Free Cash Flow	12.0x	16.5	14.5	14.7	16.6	14.6	12.3
P/S	Price to Sales	0.7x	1.3	1.3	1.4	1.5	1.5	1.5
E/P	Earnings Yield	5.9%	4.7	5.4	5.3	4.3	4.5	4.8
Div. Yield	Dividend Yield	3.6%	2.1	2.2	2.0	1.7	1.9	2.2





While these valuation measures are comforting, it is important to remember that most of these measures make assumptions about corporate earnings. Only time will tell how quickly corporate earnings will improve. Reported earnings are way down as a result of both the weak economy and the huge losses taken by the financial sector. Earnings will come back and stock prices will recover but it will take time. We should be prepared for it to take years for prices to return to recent highs. In our opinion, patience will pay off in the years ahead.