

# AEGIS / VALUE FUND

January 14, 2008

Dear Value Investor:

We are writing to provide an update on the Aegis Value Fund. We are also writing to convey our belief that the recent intense selling pressure on small-cap value stocks over the last six months is providing an unusually good entry opportunity for additional investment in the sector.

Domestic deep-value small-cap investment strategies experienced continued difficulties in the fourth quarter of 2007. Our performance in the Aegis Value Fund was no exception. The Fund declined 7.5 percent in the quarter, resulting in an overall decline of 8.2 percent for the full year—the first negative calendar year results we have experienced in nearly 10 years of operation. Difficulties in the sector have persisted into the first few weeks of 2008. While we are not at all pleased to have posted a decline of 8.2 percent during the year for the Aegis Value Fund, we are fortunate to have managed risks well enough to have avoided large declines given the difficult performance environment for deep-value stocks.

### Aegis Value Fund Performance as of December 31, 2007

	1 Year	3 Year	5 Year	Since Inception (5/15/98)
Aegis Value Fund	-8.2%	3.9%	11.6%	12.5%
Russell 2000 Value Index	-9.8%	5.3%	15.8%	8.6%

*The historical performance returns for the Aegis Value Fund are presented on a pre-tax basis. Returns include reinvestment of income and capital gains. Past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. The investment return and principal value will fluctuate so that upon redemption, an investor's shares may be worth more or less than their original cost. The Fund has an annualized expense ratio of 1.38%.*

Since mid-2007, when we were named the #1 mutual fund manager out of 928 equity managers ranked by Value Line, small-cap value has fallen very rapidly out of favor with investors, who have moved strongly to international stocks, growth and momentum strategies. The domestic “style box” returns shown in the table below tell the story of 2007. While the Russell 1000 Growth Index of large-cap stocks returned a healthy 11.8 percent during the year, the Russell 2000 Value Index of smaller value stocks declined 9.8 percent. The S&P 600 Pure Value Index and the Russell 2000 Microcap Value Index, comprised of deeper value stocks more comparable to the average market cap and price-to-book of our Fund holdings, declined a much larger 18.6 percent and 13.1 percent respectively. The recent performance disparity between the losses in these small-cap value indices and the gains in the large-cap growth stocks is unusually wide and is a relatively unusual event historically.

**Table: Characteristics and Performance of Index Portfolios in 2007**

<u>Portfolio</u>	<u>Average Market Cap</u>	<u>Price/Book</u>	<u>2007 Returns</u>	
			<u>Q4</u>	<u>Full Year</u>
Nasdaq 100 Index <sup>(1)</sup>	\$73B	4.91	0.7%	20.4%
Russell 1000 Growth <sup>(2)</sup>	\$78B	4.26	-0.8%	11.8%
S&P 500 <sup>(3)</sup>	\$110B	2.90	-3.3%	5.5%
Russell 2000 Value <sup>(2)</sup>	\$1,200M	1.56	-7.3%	-9.8%
S&P 600 Pure Value <sup>(4)</sup>	\$752M	1.43	-11.2%	-18.6%
Russell Microcap Value <sup>(2)</sup>	\$379M	1.37	-9.1%	-13.1%
Index: Small-Cap, Under 1.2x Tangible Book <sup>(5)</sup>	\$740M	0.89	-12.5%	-26.0%
Index: Small-Cap, Under 1.0x Tangible Book <sup>(5)</sup>	\$652M	0.74	-14.9%	-31.6%

Sources:

1. powershares.com and Bloomberg; valuation data as of 9/28/2007
2. russell.com; valuation data as of 11/30/2007
3. ssgafunds.com & standardandpoors.com; valuation data as of 9/28/2007
4. rydexfunds.com & standardandpoors.com; market cap as of 9/28/07 and P/B as of 1/4/2008
5. Indices built by Aegis Financial Corp to simulate passive, equal-weighted investment in small deep value securities; rebalanced quarterly

A recent analysis we performed of the universe of market caps greater than \$70 million trading at less than tangible book value, criteria we primarily use when screening for new investment opportunities, showed these securities lost an average of 16.3 percent in the third quarter of 2007. Reconstituting this index based on the same criteria at the beginning of the fourth quarter, this category of stocks showed another 14.9 percent average decline by year end. The total annual decline for this strategy would have been approximately 31.6 percent in 2007.

While we had been cautious on new small-cap, deep-value investments for some time, we did not anticipate the ferocity of the valuation compression in the deep-value sector that occurred in recent months. Deep value declines of this magnitude were especially unusual in light of the fairly docile market performance overall.

Particularly over the last half of the year, continued housing weakness, revelations of a banking crisis, increasing inflationary pressures, a rapid decline in the dollar, and rising expectations of a recession all conspired to sour investors on small- and micro-cap value stocks, which are often perceived as riskier during periods of financial distress. In our view, de-leveraging of quantitative hedge fund strategies and hedge fund redemptions are also fueling an anomalous period in which stocks with more attractive traditional valuation multiples (P/B, P/E, dividend yield) are being sold, while stocks with less attractive multiples are purchased. This is precisely the topsy-turvy market activity that is required to unwind large leveraged quantitative strategies predicated on the expected long-term superior performance of value stocks.

Furthermore, as they did in 1998 and 1999 following declines due to forced liquidations of deep-value portfolios in the wake of the Long Term Capital Management failure, investors have been reallocating funds away from small value strategies. While many are moving the proceeds into money funds and T-bills pending a more certain economic environment, others are now pursuing international strategies or momentum-driven growth strategies that look so much better in the rear-view mirror, especially now that the painful years of 2000 to 2002 are a more distant memory. Because the deep-value small-cap investment universe is small and the stocks can be illiquid, these fund outflows can work to fuel additional multiple compression in our corner of the market as managers struggle to liquidate securities to meet redemptions. As a result, many stocks in our sector have recently declined for reasons having little to do with their fundamentals.

In our view, the factors cited above have combined to create the most robust environment for new investment since early 2003. Those focused on fundamental ratios will find this the most opportunistic time to invest in our strategy in several years. At year end, our portfolio was priced at an average of 60 percent of book value, rivaling historic lows set in late 2002 and early 2003—lows from which deep value investors subsequently experienced very strong returns.

We are also optimistic about the roster of new stocks now appearing on our investment screens. The number of securities on our watchlist has increased significantly. While a large number of stocks on our screens are indeed financially distressed, and many lack the proper attributes for conservative investment, we are seeing an increasing number of fundamentally sound businesses trading at steep discounts. Many companies in our universe are now trading at such low levels that a serious recession is more than fully discounted in the price.

Many studies have clearly documented the outperformance of small-cap value stocks over long historical time spans. We believe these stocks will resume providing outstanding returns in the future. While it is impossible to predict the exact timing of a turnaround in deep value stocks, we are working diligently to position ourselves for its arrival. We are deeply invested personally in the Aegis Value Fund with Aegis employees and our families currently holding in excess of \$10 million of Fund shares, so we certainly continue to be focused on managing risk in the portfolio pending the recovery.

Should you have any questions about our performance, our investment positions, or our views on the current economic environment, please visit our website at [www.aegisvaluefund.com](http://www.aegisvaluefund.com) or call us at 703 528-7788. For routine account matters, our shareholder services reps are available via telephone at 800 528-3780.

Sincerely,



Scott L. Barbee  
Portfolio Manager  
Aegis Financial Corporation

*The Value Line fund ranking described herein ranked 928 equity fund managers based on risk-adjusted value added relative to others with the same investment objective. The ranking covers the annual period ended June 30, 2007.*

*The Aegis Value Fund is offered by prospectus only. Investors should consider the Fund's investment objectives, risks, charges, and expense. The prospectus contains this and other information about the Fund and should be read carefully before investing. To obtain a copy of the prospectus, please call us at (800) 528-3780, or visit our website at [www.aegisvaluefund.com](http://www.aegisvaluefund.com), where an online prospectus is available.*