Needham Funds

Needham Aggressive Growth Fund
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October 2008

Dear Shareholders, Friends of Needham, and Prospective Shareholders:

We are reporting in Exhibit A (attached) the performance results for the Needham Aggressive Growth Fund ("NAGF," or the "Fund"), NASDAQ symbol NEAGX, for the quarter ended September 30, 2008 ("3Q08"), the 12 months ended September 30, 2008 ("1 Year"), the three-year period ended September 30, 2008 ("3 Years"), the five-year period ended September 30, 2008 ("5 Years"), and from September 4, 2001 to September 30, 2008 ("Since Inception"). The Fund was down 1.31% for 3Q08, down 14.76% for the 1 Year, up 4.29% for the 3 Years, up 7.52% for the 5 Years, and up 6.86% Since Inception, compounded annually.

Investment returns and principal value will fluctuate, and when redeemed, shares may be worth more or less than their original cost. Shares held less than 60 days are subject to a short-term redemption fee of 2%. The results contained in this report represent past performance of the Fund. Past performance does not guarantee future results and current performance may be higher or lower than these results. Current month-end performance is available at www.needhamfunds.com.

Investment Strategy

NAGF seeks to create long-term, tax-efficient capital appreciation for its investors. To this end, NAGF targets the equities of companies with strong, above-average prospective growth rates. The Fund invests, in general, in markets and industries with strong growth rates, focusing on the market leaders in these areas. These market leaders, especially as they break away from their competitors, tend to garner a disproportionate share of the positive financial returns. Also important is the long-term sustainability of the companies' leadership positions. Thus, the Fund looks for companies with strong management teams, superior balance sheets, above-average margins that can generate excess cash, and strong R&D and brand spending in industries with high barriers to entry.

Investment Profile

As of September 30, 2008, NAGF's sector holdings consisted of the following:

Sector	Long(1)	(Short)(1)	Total(1)(2)
Healthcare	20.7%	(3.0)%	17.7%
Energy	–	–	–
Industrial	4.9%	–	4.9%
Business Services	19.2%	–	19.2%
Financial Services	–	–	–
Consumer	5.4%	–	5.4%
Technology/Cable/Telecommunications	28.6%	–	28.6%
Cash	24.2%	–	24.2%
			100.0%

(1) Based on percentage of total investments as of 9/30/08, which includes all stocks plus cash minus all short positions.
(2) Total represents the difference between the long exposure and the short exposure, which produces the net exposure.

NAGF's top ten holdings at the end of the third quarter (in descending order of market value) were Express Scripts, Inc., Alliance Data Systems Corp., Gilead Sciences, Inc., Microsemi Corp., Iron Mountain, Inc., Precision Castparts Corp., Crucell NV, Parametric Technology Corp., ViaSat, Inc. and Dolby Laboratories, Inc. The top ten holdings represented 45.61% of total investments. Please note that current portfolio holdings may not be indicative of future portfolio holdings. At the end of the third quarter, the market value of stocks sold short represented 3.00% of the total investments held by NAGF.

Investment Analysis

As we write this letter on October 13, two weeks have gone into making the fourth quarter of 2008 already more important to the performance of your portfolio than any other period since the inception of the Fund. The third quarter felt like it had more than 90 calendar days, but that was nothing compared to the first 14 days of the current quarter, which felt like an eternity. A meltdown of the global financial system was not something we had anticipated and, as such, the performance of the Fund was disappointing, as your capital suffered losses this quarter that continued through October 10. It gives us some solace that we lost you 1.31% in 3Q08, compared to a loss of 9.07% and 8.74% in the NASDAQ Composite Index and the S&P 500 Index, respectively.

We all witnessed the damage created by lost trust in credit, counterparty risk, banks and even governments, or at least, their agencies. Credit froze and cash became king to the point of treasuries briefly yielding negative returns. How did we get there is now all too clear, but that knowledge came a little late to most, including us. We express our opinion on the matter only as potential guidance on how to solve our difficult challenges ahead. We surmise that in the late '90s, the emergence of BRICs and the export of capital to these new opportunities challenged our economy more than we admitted. The significant and damaging transfer of wealth was temporarily cured by the Internet Bubble, but as this support evaporated, political pressure to turbocharge "affordable housing" had the benefit of stimulating real estate, our crown jewel ($25 trillion value, about 17% of GDP equivalent, 8 million jobs) and the last resort for massive economic uplift. The accompanying boost in financial services was also pleasing as it provided massive employment and tax inflows. The only problem is that it was fake, creating non-existing values, financed with illusory guarantees that were all bound to crash from the get go. And they did in October. The Federal Reserve and other central banks, good firefighters that they are, ran to the rescue with their 1929 vintage tool kit and hoses, which fell way short outside of the commercial banks perimeter. It took a few weeks for them and the rest of the world to figure out that they needed broader, extended hoses that could throw unlimited amounts of dollars to virtually any part of the globe. That is where we are today: 1) repairing the broken credit pipes, with significant private and soon to come state equity infusions into the surviving banks; and 2) jumpstarting credit flows with additional public guarantees on short-term credit markets and likely the medium-term credit markets, starting later this month.

As to our activities during the quarter, I can assure you that we worked extra hard at assessing the situation in the midst of extreme volatility and lack of transparency. We are not keen to sell when valuations are low and when the long term is clearly more promising than the short term. Acting such as doubling down or selling seemed irrational, so the rational thing to do became to sit tight and focus on stocks we owned. In these times of higher uncertainty, we had to rely more on history and our investing principles, which helped us perform well in the past. Our anchor remained fundamental value. On the bright side, we successfully exited a number of positions before they declined substantially, such as Community Health Systems, DemandTec, Guess, Hansen Medical, Interactive Brokerage, Mobile Mini, NuVasive, Portfolio Recovery and Thermage. We benefited a little from the successful takeover of our lone German stock, Epcos. Our short position and increasing cash position also helped offset a generally merciless market. We had no exposure to financials or energy stocks, killers this quarter. Given the high volatility of the environment, we "traded" a couple of times during the quarter, something we typically resist doing, but we felt compelled to close these positions when our price objectives were met. In summary, we kept faithful to our investing style and remained focused on our long-term performance, realizing that the short-term pains should not make us forget our long-term objectives. We know from experience that fast runners cannot finish marathons. We have long ago elected not to compete with fast money.

Investment Outlook

As to the outlook, it is clear that, as a nation, we have now realized that we cannot easily undertake simultaneous and massive investments in emerging countries and in "affordable housing," particularly when we botch both jobs. It is also clearly realized that private transactions (such as swaps) are illiquid and should not play a major role in public companies or commercial banks. All swaps should be regulated and the bulk of them should trade publicly. The commercial banks, force-fed with state preferred, will have little choice but to lend, initially to each other at a de minimis margin and rapidly to worthwhile credits. Under this scenario, the future of the equity markets will be less impacted by liquidity as they were in the past few months and more affected by “policy,” of which we can expect plenty, now that government prevails over credit. As to what policy will be, we have no real clue until the results of the election become clear. The priority will undoubtedly go to restore the wealth and jobs wasted during our ill-fated pursuits in excess credit and real estate investments. Large job-creating sectors, such as healthcare, education and infrastructure rebuild, are likely to rank high on any political agenda. Stay tuned for at least a few weeks.

Confidence, we have learned, can turn on a dime. It is a switch with either a zero or a one handle. While it remains to be seen how rapidly the horror of despair can vanquish from memory, our economy has real, lasting issues. As the credit woes unwind over the next few months, we expect less volatility in the stock market, which should allow us to more comfortably do our job of picking good growth stocks for you. Our small- and mid-cap names may not be immediately favored as return-to-risk will advantage larger, global caps. We will stick to the area though as small caps typically lead the recovery, with nimble management and credit independence. We will continue to upgrade the portfolio with higher quality names that our thrifty approach generally prevents us from buying. We will continue to apply the same three criteria which always guide us in selecting a stock: strong management, clear and superior growth (from top line, expanding margins and cash generation) and, of course, a discount to true value. We thank you for your continuing support.

If you have any questions, thoughts or concerns, please do not hesitate to contact us at (800) 625-7071 or visit our Web site at *www.needhamfunds.com*.

Sincerely,

Bernard H. Lirola

Bernard Lirola
Portfolio Manager

This report is not an offer of the Needham Aggressive Growth Fund. Shares are sold only through the currently effective prospectus, which must precede or accompany this report. *Please read the prospectus and consider the investment objectives, risks, charges and expenses of the Fund carefully before you invest. The prospectus contains this and other information about the Fund. Investment returns and principal value will fluctuate, and when redeemed, shares may be worth more or less than their original cost. Shares held less than 60 days are subject to a short-term redemption fee of 2%. The results contained in this report represent past performance of the Fund. Past performance does not guarantee future results and current performance may be higher or lower than these results. Current month-end performance is available at www.needhamfunds.com.* Total return figures include reinvestment of all dividends and capital gains. The investment risks of the Fund are increased by the Fund’s non-diversified status and by the Fund’s ability to invest in smaller company stocks, privately held companies and IPOs. Also, the Fund’s use of short sales, options, futures strategies and leverage may result in significant capital loss.

To obtain a copy of the Fund’s current prospectus, please contact the Fund’s transfer agent, Citi Fund Services Ohio, Inc., at (800) 625-7071.

Needham & Company, LLC, member NASD/SIPC, is the distributor of The Needham Funds, Inc.

Exhibit A

Our performance relative to the major indices for these periods is as follows:

	3Q08 (6)	1 Year (7)	3 Years (8) (9) (10)	5 Years (8) (11) (12)	Since Inception (8) (13) (14)
Needham Aggressive Growth Fund (1)(2)	-1.31%	-14.76%	4.29%	7.52%	6.86%
Needham Aggressive Growth Fund *(after taxes on distributions)*	-1.31%	-16.46%	2.31%	6.29%	5.86%
Needham Aggressive Growth Fund *(after taxes on distributions and redemption)*	-0.85%	-7.07%	3.15%	6.11%	5.60%

Benchmarks	3Q08 (6)	1 Year (7)	3 Years (8) (10)	5 Years (8) (12)	Since Inception (8) (14)
S&P 500 Index (3)	-8.74%	-23.00%	0.22%	5.16%	3.44%
NASDAQ Composite Index (4)	-9.07%	-23.05%	-0.14%	3.94%	4.38%
Russell 2000 Index (5)	-1.39%	-16.48%	1.86%	8.18%	8.12%

1. *Total Annual Fund Operating Expenses are 2.47%.*
2. *Investment results calculated after reinvestment of dividends.*
3. *The S&P 500 Stock Index is a broad unmanaged measure of the U.S. stock market.*
4. *The NASDAQ Composite Index is a broad-based capitalization-weighted index of all NASDAQ Global Market and Small Cap stocks.*
5. *The Russell 2000 Index is a broad unmanaged index composed of the smallest 2,000 companies in the Russell 3000 Index.*
6. *7/1/08 – 9/30/08.*
7. *10/1/07 – 9/30/08.*
8. *Compound annual growth rate. Assumes all dividends are reinvested in shares of the Fund.*
9. *Cumulative return for the three years was 13.43%, assuming all dividends were reinvested in shares of the Fund.*
10. *10/1/05 – 9/30/08 (annualized return).*
11. *Cumulative return for the five years was 43.69%, assuming all dividends were reinvested in shares of the Fund.*
12. *10/1/03 – 9/30/08 (annualized return).*
13. *Cumulative return since inception was 59.87%, assuming all dividends were reinvested in shares of the Fund.*
14. *The inception date of the Fund was 9/4/01. 9/4/01 – 9/30/08 (annualized return).*

Note: *The average annual returns shown in the above table and accompanying footnotes are historical, reflect changes in share price and are net of expenses. Investment results and the principal value of an investment will vary. Past performance noted above does not guarantee future results. When shares are redeemed, they may be worth more or less than their original cost. Since inception, the Fund's Adviser has absorbed certain expenses of the Fund, without which returns would have been lower.*

The after-tax returns are shown in two ways: (1) assuming that an investor owned the Fund during the entire period and paid taxes on the Fund's distributions; and (2) assuming that an investor paid taxes on the Fund's distributions and sold all shares at the end of each period.

After-tax returns are calculated using the highest historical individual federal income tax rate and do not reflect the impact of state and local taxes. Actual after-tax returns depend on an investor's tax situation and may differ from those shown, and after-tax returns shown are not relevant to investors who hold their Fund shares through tax-deferred arrangements, such as 401(k) plans or individual retirement accounts.