Annual Report

Needham Growth Fund

Year ended December 31, 1998

Needham Funds

Needham Funds

Needham Growth Fund
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Annual Report
for the year ended December 31, 1998

Needham Growth Fund — seeking to build wealth for long-term investors.

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December 1998

Dear Shareholders, Friends of Needham and Prospective Shareholders,

We are pleased to report performance results for the Needham Growth Fund ("NGF") for the quarter ended December 31, 1998 (4Q98), for the year ended December 31, 1998 (1998) and for the three year period ended December 31, 1998 (3 Years). Our performance relative to the major indices for these periods is as follows:

Benchmarks	4Q98	1998	3 Years[6]
Needham Growth Fund[1]	26.06%	19.85%	28.08%[7]
Dow Jones Industrial Average[2]	17.58%	18.15%	23.84%
S&P 500 Index[3]	21.28%	28.58%	28.13%
S&P 400 Midcap Index[4]	28.16%	19.09%	23.29%
Russell 2000 Index[5]	16.44%	(2.24)%	11.64%

1. Investment results calculated after reinvestment of dividends.
2. Dow Jones Industrial Average is a daily measure of selected stocks traded on the NYSE.
3. S&P 500 stock index is a broad unmanaged measure of the U.S. stock market and is not available for purchase.
4. S&P 400 Midcap stock index is a broad unmanaged measure of the U.S. stock market and is not available for purchase.
5. Russell 2000 stock index is a broad unmanaged index comprised of the smallest 2000 NASDAQ companies and is not available for purchase.
6. Compound average annual growth rate. Assumes all dividends are reinvested in shares of the Fund.
7. Total return for the 3 Years was 110.09%, assuming all dividends are reinvested in shares of the Fund.

Note: The average annual returns shown above are historical and reflect changes in share price, reinvested dividends 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.

Background

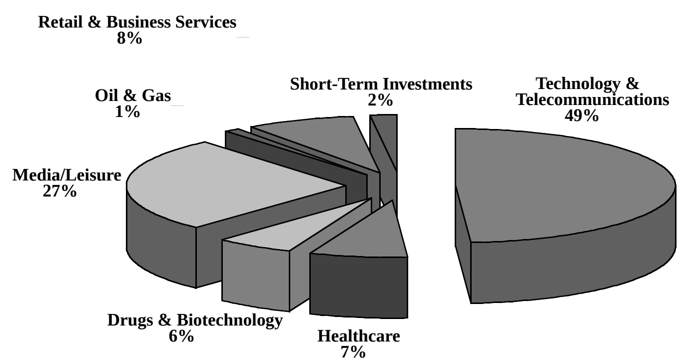
The fourth quarter 1998 for the Needham Growth Fund (the "Fund" or "NGF") was the quarter of the "Comeback Kid". To the surprise of many and after a very difficult third quarter owing to domestic earnings concerns, international dislocations and some credit crises, the Federal Reserve, in a series of rapid fire moves, lowered short term interest rates. Corporate third quarter earnings, to the surprise of many, turned out to be better than expected, especially for our technology companies.

Investment Strategy

NGF seeks to create long-term tax efficient capital appreciation for its investors. To this end, NGF targets companies with products or services that are selling or marketing into high growth markets. They normally have earnings growth of at least 20%, product and market dominance, and the ability to consolidate their market positions. They may have a competitive advantage by acquiring and retaining more customers, driving costs down and profits up. NGF also looks for seasoned and motivated management with "incentives" to win. Companies with these characteristics sometimes find themselves in a temporary earnings downturn or shortfall or may be in a product transition. This often causes aggressive growth and momentum investors to sell. At this point, NGF may deem the stock to be reasonably priced and purchase it for long-term capital appreciation. Hence, the discipline called, "Growth At a Reasonable Price" ("GARP").

Investment Profile

At December 31, 1998, NGF's sector holdings consisted of the following:



The market value of stocks sold short represented approximately 9.2% of the total value of the long portfolio held by the Needham Growth Fund.

NGF's top ten holdings at quarter end (in descending order of market value) were Tele-Communications, Inc. Series A Liberty Media Group, Sanmina Corp., Comcast

Corp., Class A, Envoy Corp., Cablevision Systems Corp., Class A, Aspen Technology, Inc., Fore Systems, Inc., Analog Devices, Inc., Galileo Technology, Ltd., and Park Electrochemical Corp.

Investment Analysis

The technology sector, in general, continues to offer extremely attractive long term growth opportunities. Early in the fourth quarter we were fortunate enough to have had many technology stocks that we had wanted to buy earlier in the year fall to a level consistent with our investment discipline of GARP. We therefore took significant positions in high quality mid-cap names such as Actel Corp., Analog Devices, Inc., Fore Systems, Inc., Park Electrochemical Corp., and Sanmina Corp. In general, the semiconductor manufacturing, semiconductor capital equipment, contract manufacturing and networking equipment areas provided us with excellent capital appreciation during the quarter. The enterprise software area was generally disappointing and therefore this is the area where we have concentrated many of our short positions. There are now some good values for the long term investor in this area and we have raised our exposure accordingly. Obviously the Internet, as a means of communication, entertainment and commerce, is having a fundamental impact on the way we live our lives and transact our business. It stands in importance on a level with the invention of radio, television and the telephone. From an investment point of view, few of these stocks fall within our GARP discipline and therefore we have chosen to focus on indirect or derivative themes in e-commerce and the Internet.

The media, leisure, entertainment, cable and media content companies continue to provide good capital appreciation and stability to the portfolio. The cable and entertainment stocks in particular provided outstanding returns in 1998 following similar returns in 1997 and so we have begun to take some profits at these prices. The media content and leisure stocks however still provide good upside potential in our opinion, especially Tele-Communications, Inc. Series A Liberty Media Group. Several Internet exposures are held through stocks in this area, as alluded to in the previous paragraph.

In the healthcare, drugs and biotechnology areas, we focused our exposure in the healthcare outsourcing area and reduced our exposure to Physicians Practice Management (PPM) and Health Management Organization (HMO) companies. We have maintained our investments in the drug and biotechnology areas. In early October we initiated positions in Envoy Corp. in the outsourcing area and Conmed Corp. in the medical devices area.

In retailing and business services, we continue to maintain a small exposure. Our most significant exposure remains First Data Corp. and Harte-Hanks Inc., which both have Internet exposure. While the business services exposure remains unchanged, we have reduced our direct retailing exposure.

Outlook

After the Fed easing, the better than expected corporate earnings last autumn and continued low inflation, institutional and retail investors took heart and the flow of funds into equities increased substantially. So far in 1999, that trend has continued with an ever narrowing focus on the large-cap, liquid stocks, led in technology by the “four horsemen”, Intel Corp., Microsoft Corp., Cisco Systems Inc., and Dell Computer Corp. These are great companies, which we would love to own but unfortunately they are not priced within the GARP discipline at this time.

So the extraordinary “Goldilocks” economy continues with Gross Domestic Product (GDP) growth for 1998 at a 14 year high of 4.1%, the lowest inflation level since the late 50’s and low interest rates. Institutions and retail investors are still flush with cash (as defined by mutual funds inflows and outflows) and the advent of electronic day trading has created a new category of “investors” who do not subscribe to more traditional equity evaluation methods and investment criteria. What can go wrong? We are concerned about the lack of breadth of the market (the NASDAQ 100 – Russell 2000 spread is at an all time high), the excessive focus on momentum rather than growth and value investing and the torrid pace of new issuances of equity securities. The large-cap “new-era nifty fifty” look expensive to us!

On balance though, we are constructive on the outlook for 1999 with productivity gains and moderate wage gains benefiting the economy. In addition, expenditures for productivity enhancing capital equipment are at a 15 year high and unit labor costs should show very little upward pressure. We believe that we could be looking at 3 – 4% GDP growth in 1999, inflation of 1% and continued productivity gains. This bodes well for corporate profits and thus the equity market.

The Fund has decreased its holdings in the larger mid-cap stocks and increased its holdings in the smaller spectrum of mid-cap stocks. We believe that these smaller stocks are a “call-option” on the next leg of the economic cycle which could come with the rejuvenation of the Asian economies, any accelerating growth in the European economies and the continued strength in the U.S. economy.

We are looking forward to a successful and prosperous 1999 in the markets and for the Fund. In early January, we were awarded a 5 star overall rating by *Morningstar*™ for our three year performance. This places us in the top 10 percent of all domestic equity funds(1). We received a similar rating from *Mutual Fund Magazine*. It’s gratifying to us that prominent rating services rank the Fund so highly. This is independent confirmation of our outstanding performance.

Your Investment in the Needham Growth Fund

We as fellow shareholders in the Needham Growth Fund realize that there are thousands of mutual funds for you to choose among to entrust your savings whether your purpose is to invest to fund your retirement, a child's education, travel, a new business or a new home. We will continue to work hard to justify your confidence.

The Needham Growth Fund is a no-load fund. It sells and redeems its shares at the net asset value without any sales charge or redemption fees. The minimum initial investment for individuals, corporations and partnerships, IRA's or trusts is $1500. There is a $100 minimum for subsequent purchases. The minimum for purchases made pursuant to the Needham Growth Fund's Automatic Investment Plan is $1500 with a $50 monthly minimum for subsequent purchases.

The Prospectus sets forth concisely the essential information a prospective investor should know before investing. Investors are advised to read the Prospectus and retain it for future reference. A Statement of Additional Information containing additional and more detailed information about the Needham Growth Fund has been filed with the Securities and Exchange Commission and is incorporated by reference in the Prospectus. A copy of the Statement of Additional Information may be obtained without charge by writing or calling the Needham Growth Fund at the address and telephone number set forth above.

A copy of the Prospectus and the Statement of Additional Information is also available through the Needham Growth Fund web site at http://www.needhamco.com. The Securities and Exhange Commission maintains a web site (http://www.sec.gov) that contains the Prospectus, the Statement of Additional Information, material incorporated by reference and other information regarding the Needham Growth Fund.

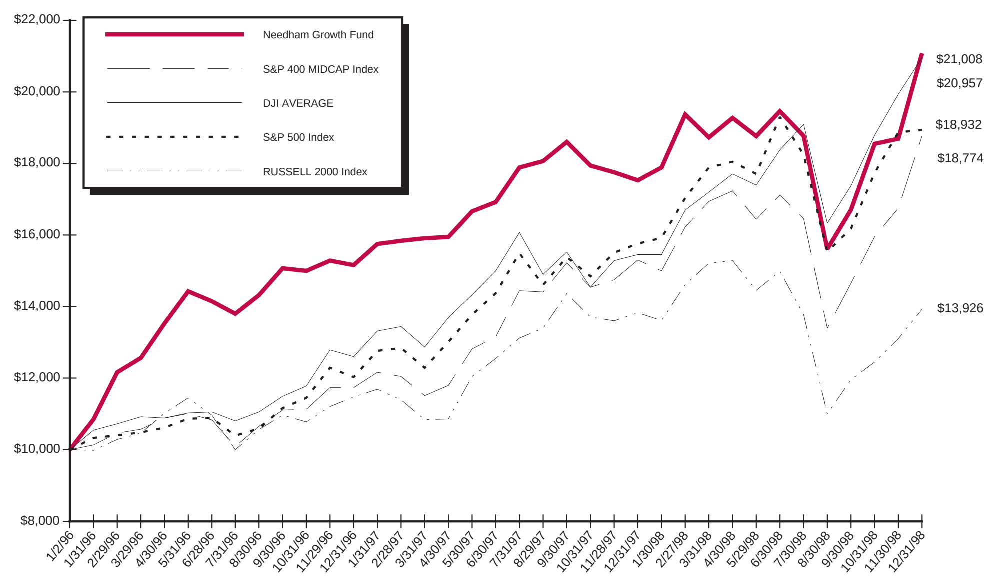
The Needham Growth Fund thanks you for your investment, interest, support and confidence. If you have any questions, thoughts or concerns, please do not hesitate to call us at 212/705-0327.

Yours sincerely,

Peter J. R. Trapp
Portfolio Manager

NEEDHAM GROWTH FUND
Comparative Investment Returns

An initial investment of $10,000 as of January 1, 1996 (inception) would be worth $21,008 as of December 31, 1998



The above illustration compares a $10,000 investment in the Needham Growth Fund on January 1, 1996 to a $10,000 investment in the noted benchmarks on that date. All dividends and capital gain distributions are reinvested.

The Fund's performance takes into account all applicable fees and expenses. The benchmarks are widely accepted unmanaged indices of overall market performance and do not take into account charges, fees and other expenses.

Past performance is not predictive of future performance. The Fund's share price and return will vary so that an investor's shares, when redeemed, may be worth more or less than their original cost.

(1) Morningstar proprietary ratings reflect risk-adjusted performance as of December 31, 1998. The ratings are subject to change every month. Past performance is no guarantee of future results. Morningstar ratings are calculated from a fund's three year, five and ten year (if applicable) average returns in excess of 90-day Treasury bill returns with appropriate fee adjustments, and a risk factor that reflects fund performance below 90-day Treasury bill returns. The top 10% of the funds in an investment class receive Five (5) Stars. The fund was rated among 2,802 funds in the Domestic Equity class for the three year period.

Statement of Net Assets

December 31, 1998

	Shares	Value
Common Stocks - (97.0%)		
Apparel/Footwear Manufacturers - (1.5%)		
Wolverine World Wide, Inc.	20,000	$ 265,000
Broadcasting - (7.7%)		
Tele-Communications, Inc., Series A Liberty Media Group*	30,000	1,381,875
Business Services - (5.7%)		
Convergys Corp. *	20,000	447,500
Harte-Hanks, Inc.	20,000	570,000
		1,017,500
Cable TV - (9.1%)		
Cablevision Systems Corp., Class A *	15,000	752,813
Comcast Corp., Class A	15,000	880,313
		1,633,126
Computer Software - (10.5%)		
Aspen Technology, Inc. *	50,000	725,000
CBT Group Public Limited Co.	30,000	446,250
Hyperion Solutions Corp. *	10,000	180,000
Novell, Inc. *	30,000	543,750
		1,895,000
Contract Manufacturing & Materials - (11.8%)		
Hadco Corp. *	10,000	350,000
Park Electrochemical Corp. *	20,000	572,500
Sanmina Corp. *	19,090	1,193,125
		2,115,625
Data Processing - (2.6%)		
First Data Corp.*	15,000	475,313
Diversified Industries - (1.1%)		
Varian Associates, Inc. *	5,000	189,375
Healthcare Outsourcing Services - (5.5%)		
Envoy Corp. *	13,000	757,250
PSS World Medical, Inc. *	10,000	230,000
		987,250
Hospital & Physician Management - (0.4%)		
PhyCor, Inc. *	10,000	68,125

See accompanying notes to financial statements.

Statement of Net Assets (continued)

December 31, 1998

	Shares	Value
Leisure & Entertainment - (9.8%)		
Hasbro, Inc.	10,000	$ 361,250
News Corp., Ltd. Sponsored ADR	20,000	528,750
USA Networks, Inc.	15,000	496,875
Viacom, Inc., Class B *	5,000	370,000
		1,756,875
Medical Devices - (2.8%)		
CONMED Corp. *	15,000	495,000
Networking & Communications - (10.0%)		
3Com Corp. *	10,000	448,125
Ciena Corp. *	20,000	292,500
Fore Systems, Inc. *	35,000	640,935
Premisys Communications, Inc. *	20,000	183,750
Shiva Corp. *	40,000	226,250
		1,791,560
Oil Equipment & Services - (1.3%)		
Varco International, Inc. *	30,000	232,500
Pharmaceuticals - (3.1%)		
Pharmacia & Upjohn, Inc. *	10,000	566,250
Retailing - (1.1%)		
PETCO Animal Supplies, Inc. *	20,000	201,250
Semi-Conductor Manufacturers - (11.7%)		
Actel Corp. *	20,000	400,000
Analog Devices, Inc. *	20,000	627,500
Atmel Corp. *	30,000	459,375
Galileo Technology, Ltd. *	22,500	607,500
		2,094,375
Semi-Conductor Capital Equipment - (1.3%)		
Photronics, Inc. *	10,000	239,688
Total Common Stocks (Cost $12,201,169)		**17,405,687**

	Par	
Short-Term Investments - (1.7%)		
Commercial Paper		
Burlington Resources 5.20%, Due 01/04/99		
(Cost $299,870)	$ 300,000	299,870

	Shares	
Investment Companies - (1.5%)		
H & Q Healthcare Investors Fund	10,249	149,892
H & Q Life Sciences Investors Fund	10,237	122,844
Total Investment Companies (Cost $314,807)		**272,736**

See accompanying notes to financial statements.

	Number of Contracts	*Value*
Name/Expiration Date/Strike Price		
Put Options Purchased - (0.1%)		
Standard & Poor's 500 Index, Jan., $1,150 (Cost $155,150)	50	$ 13,750
Total Investments - (100.3%) (Cost $12,970,996)		**17,992,043**

Other Liabilities in Excess of Assets - (-0.3%)	
Receivable from Brokers for Securities Sold Short and Investment Securities Sold	1,755,557
Other Assets	114,000
Payable for Investment Securities Purchased	(110,328)
Payable for Fund Shares Redeemed	(66,048)
Net Amounts due to Affiliates	(9,642)
Securities Sold Short, at Value (proceeds - $1,734,426)	(1,650,875)
Other Liabilities	(78,930)
	(46,266)
Net Assets - (100.0%) (Applicable to 1,039,181 shares outstanding $.001 par value, 1,000,000,000 shares authorized)	$ 17,945,777
Net Asset Value, Offering and Redemption Price Per Share	**$ 17.27**

** Non-Income producing security*
ADR - American Depository Receipt

See accompanying notes to financial statements.

Schedule of Securities Sold Short

December 31, 1998

Name of Issuer	Shares	Value
Common Stocks		
Barra, Inc.	10,000	$ 236,250
May Department Stores Co.	5,000	301,875
ProBusiness Services, Inc.	7,500	341,250
SAP AG - Sponsored ADR	8,000	288,500
UBid, Inc.	2,000	213,250
Venator Group, Inc.	20,000	128,750
Wind River Systems, Inc.	3,000	141,000
Total Securities Sold Short (Proceeds $1,734,426)		**$ 1,650,875**

See accompanying notes to financial statements.

Statement of Operations

For the year ended December 31, 1998

Investment Income	
Interest	$ 77,956
Dividends	66,861
Total Investment Income	**144,817**
Expenses	
Investment Advisory fee	230,585
Administration and Accounting fee	65,000
Distribution fees	46,685
Custodian fee	44,710
Legal fee	40,000
Directors' fees	33,000
Transfer Agent fee	30,000
Audit fee	27,000
Organization expenses	26,500
Shareholders' reports	20,055
Other expenses	70,397
Total Expenses	**633,932**
Expenses Waived and Reimbursable	(172,712)
Net Expenses	**461,220**
Net Investment Loss	**(316,403)**
Net Realized and Unrealized Gain (Loss) on Investment Securities	
Net Realized Gain on Investment Securities	859,523
Net Realized Loss on Option Contracts	(1,413,201)
Change in Unrealized Appreciation of Investment Securities	4,157,666
Net Gain on Investment Securities	**3,603,988**
Net Increase in Net Assets Resulting from Operations	**$3,287,585**

See accompanying notes to financial statements.

Statements of Changes in Net Assets

	Year Ended December 31, 1998	*Year Ended December 31, 1997*
Increase (Decrease) in Net Assets		
Operations:		
Net Investment Income (Loss)	$ (316,403)	$ 86,118
Net Realized Gain on Investment Securities	859,523	5,483,523
Net Realized Loss on Option Contracts	(1,413,201)	(2,314,395)
Change in Unrealized Appreciation (Depreciation) of Investment Securities	4,157,666	(267,995)
Net Increase in Net Assets Resulting from Operations	**3,287,585**	**2,987,251**
Distributions From:		
Net Investment Income	(6,838)	(76,131)
Net Realized Gains	(4,559)	(3,428,667)
In Excess of Net Realized Gains	—	(37,925)
Total Distributions	(11,397)	(3,542,723)
Capital Share Transactions (1):		
Shares Issued	3,303,039	23,293,242
Shares Issued in Reinvestment of Distributions	10,402	3,271,954
Shares Redeemed	(10,412,888)	(18,620,014)
Net Increase (Decrease) from Capital Share Transactions	(7,099,447)	7,945,182
Total Increase (Decrease) in Net Assets	**(3,823,259)**	**7,389,710**
Net Assets		
Beginning of Year	21,769,036	14,379,326
End of Year	$17,945,777	$21,769,036
(1) Shares Issued and Redeemed:		
Shares Issued	216,122	1,459,181
Shares Reinvested	768	218,994
Shares Redeemed	(687,394)	(1,160,681)
	(470,504)	517,494

See accompanying notes to financial statements.

Financial Highlights

For a Share Outstanding Throughout each Year	*Year Ended December 31, 1998*	*Year Ended December 31, 1997*	*Year Ended December 31, 1996(*)*
Net Asset Value, Beginning of Year	$14.42	$14.49	$10.00
Income From Investment Operations			
Net Investment Income (Loss)	(0.30)	0.06	(0.11)
Net Gain on Securities (Realized and Unrealized)	3.16	2.26	5.27
Total From Investment Operations	2.86	2.32	5.16
Less Distributions			
Net Investment Income	(0.01)	(0.05)	—
Net Realized Gains	—	(2.31)	(0.67)
In Excess of Net Realized Gains	—	(0.03)	—
Total Distributions	(0.01)	(2.39)	(0.67)
Net Asset Value, End of Year	**$17.27**	**$14.42**	**$14.49**
Total Return	**19.85%**	**15.66%**	**51.56%**
Net Assets, End of Year (thousands)	$17,946	$21,769	$14,379
Ratios/Supplemental Data			
Ratio of Expenses to Average Net Assets	2.50%(a)	2.50%(a)	2.50%(a)
Ratio of Net Investment Income (Loss) to Average Net Assets	(1.72)%(a)	0.37%(a)	(1.27)%(a)
Portfolio Turnover Rate	585.63%	724.08%	568.93%

(a) Had certain waivers and reimbursements not been in effect, the ratio of expenses to average net assets, for the years ended December 31, 1998, 1997 and 1996 would have been 3.44%, 3.29% and 4.60%, respectively and the ratio of net investment income (loss) to average net assets, for the years ended December 31, 1998, 1997 and 1996 would have been (2.66%), (0.42%) and (3.37%), respectively.

(*) Fund commenced operations on January 1, 1996.

See accompanying notes to financial statements.

Notes to Financial Statements

1. Organization

Needham Growth Fund (the "Fund") is a portfolio of The Needham Funds, Inc., which is registered under the Investment Company Act of 1940 as a non-diversified, open-end management investment company. The Needham Funds, Inc. was organized as a Maryland corporation on October 12, 1995. Prior to the Fund's commencement of operations on January 1, 1996, it had no operations other than the issuance of 54,000 shares for $540,000.

2. Significant Accounting Policies

Security Valuation: Investments in securities (including options) listed or traded on a nationally recognized securities exchange are valued at the last quoted sales price on the date the valuations are made. Securities regularly traded in the over-the-counter market are valued at the last quoted sales price on the NASDAQ System. If no sales price is available for a listed or NASDAQ security, or if the security is not listed on NASDAQ, such security is valued at a price equal to the mean of the latest bid and ask prices. All other securities and assets for which market quotations are not readily available are valued at their fair value as determined in good faith under procedures established by and under the general supervision of the Fund's Board of Directors.

Federal Income Taxes: The Fund's policy is to comply with the requirements of the Internal Revenue Code that are applicable to regulated investment companies and to distribute all its taxable income to its shareholders. Therefore, no federal income tax provision is required. During the year ended December 31, 1998, the Fund reclassed $313,254 of accumulated net investment loss to paid-in-capital. Net investment loss and net assets were not affected by this reclassification. At December 31, 1998, the Fund had a capital loss carryforward for federal income tax purposes of $838,712, which is available as a reduction of future net capital gains realized before the year 2006.

Organizational Costs: Organizational costs have been capitalized and are being amortized on a straight line basis over a period of 60 months.

Other: Security transactions are accounted for on the date the securities are purchased or sold. Costs used in determining realized gains and losses on the sale of investment securities are those of specific securities sold. Dividend income and distributions to shareholders are recorded on the ex-dividend date. Interest income is recorded on an accrual basis.

Use of Estimates: The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

3. Investment Advisory And Administrative Services

The Fund has engaged Needham Investment Management L.L.C. (the "Advisor") to manage its investments. The Fund pays the Advisor a fee at the annual rate of 1.25% of the average daily net asset value of the Fund.

The Advisor has voluntarily agreed to waive its fee and to reimburse expenses of the Fund in an amount that operates to limit annual operating expenses for the year ended December 31, 1998 to not more than 2.50% of average daily net assets. For the year ended December 31, 1998, the Advisor waived $172,712 of its fee. Included in the Statement of Net Assets as of December 31, 1998, is net amounts due to affiliates of $9,642, which represents investment advisory fee payable net of amounts to be reimbursed to the Fund from the Advisor.

PFPC, Inc. ("PFPC") acts as the Fund's Administrator. The Fund pays PFPC a fee at the annual rate of 0.10% of the average daily net asset value of the Fund, subject to certain minimums. PFPC also acts as the Fund's shareholder servicing agent and transfer agent.

Certain officers and directors of the Fund are also officers and directors of the Advisor.

4. Distribution Plan

The Fund has adopted a Distribution Plan pursuant to Rule 12b-1 under the Investment Company Act of 1940. Under the plan, the Fund pays Needham & Company, Inc., an affiliate of the Advisor, and any other distributor or financial institution with which the Fund has an agreement, a fee at an annual rate of 0.25 of 1% of the Fund's daily average net assets. For the year ended December 31, 1998, the Fund incurred $46,685 of distribution fees, which were primarily paid to Needham & Company, Inc.

5. Investment Transactions

The following summarizes the aggregate amount of purchases and sales of investment securities and securities sold short, excluding short-term securities, during the year ended December 31, 1998.

	Purchases	Sales
Long transactions	$ 100,512,585	$103,864,205
Short sale transactions	36,799,189	34,007,594
Total	$137,311,774	$137,871,799

At December 31, 1998, net unrealized appreciation of $5,104,598 was comprised of gross unrealized appreciation and depreciation for financial reporting and federal income tax purposes of $5,857,150 and $752,552, respectively.

6. Option Transactions

The Fund may write call options on securities it owns or has the right to acquire, and may purchase put and call options on individual securities and indices written by others. Put and call options give the holder the right to sell or purchase, respectively, a specified amount of a security at a specified price on a certain date.

Put and call options purchased are accounted for in the same manner as portfolio securities. The cost of securities acquired through the exercise of call options is increased by the premium paid. The proceeds from securities sold through the exercise of put options are decreased by the premiums paid. Options on stock indices differ from options on securities in that the exercise of an option on a stock index does not involve delivery of the actual underlying security and is settled in cash only.

When the Fund writes an option, the premium received by the Fund is recorded as a liability and is subsequently adjusted to the current market value of the option written. Premiums received from writing options which expire unexercised are recorded by the Fund on the expiration date as realized gains from option transactions. When the Fund enters into a closing purchase transaction, the Fund realizes a gain or loss equal to the difference between the cost of a closing purchase transaction and the premium received when the call option was written. If a call option is exercised, the premium is added to the proceeds from the sale of the underlying security in determining whether the Fund has a realized gain or loss.

A summary of call options written by the Fund for the year ended December 31, 1998 is as follows:

Options Written	Number of Contracts	Premium Received
Options outstanding at January 1, 1998	0	$0
Options written	250	110,496
Options expired	(100)	(58,448)
Options exercised	(150)	(52,048)
Options terminated in closing transactions	0	0
Options outstanding at December 31, 1998	0	$0

7. Short Sale Transactions

During the year ended December 31, 1998, the Fund sold securities short. An equivalent amount of securities owned by the Fund are segregated as collateral while the short sale is outstanding. At December 31, 1998, the market value of securities separately segregated to cover short positions was $1,809,375. For financial statement purposes, an amount equal to the settlement amount is included in the Statement of Net Assets as an asset and an equivalent liability. The amount of the liability is subsequently marked-to-market to reflect the current value of the short position. Securities sold short at December 31, 1998 and their related market values and proceeds are set forth in the Schedule of Securities Sold Short.

8. Components of Net Assets

At December 31, 1998 net assets consisted of:

Paid-in-Capital	$13,437,341
Accumulated Net Realized Loss	(596,162)
Net Unrealized Appreciation of Investment Securities	5,104,598
Total Net Assets	$17,945,777

Report of Independent Public Accountants

To the Shareholders and Board of Directors
of Needham Growth Fund:

We have audited the accompanying statement of net assets of Needham Growth Fund (a portfolio of The Needham Funds, Inc.), including the schedule of securities sold short, as of December 31, 1998, and the related statements of operations, changes in net assets and financial highlights for the year then ended. These financial statements and financial highlights are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audit. The financial statements of Needham Growth Fund as of December 31, 1997, were audited by other auditors whose report dated February 23, 1998, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 1998, by correspondence with the custodian and brokers. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Needham Growth Fund as of December 31, 1998, the results of its operations, changes in its net assets and financial highlights for the year then ended, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

New York, New York
February 19, 1999

Tax Information (unaudited)

During 1998, the Fund made the following distribution which you may have received depending on your ownership at the time of the distribution:

Record Date	Payment Date	Total	Ordinary Income	Long-Term Capital Gains
09/14/98	09/17/98	$0.010	$0.006	$0.004

The distribution of ordinary income paid to you in cash or reinvested in your account during 1998 is taxable as ordinary income for Federal income tax purposes.

Distributions of long-term capital gains are taxable as such whether paid to you in cash or reinvested in your account during 1998, regardless of the length of time shares were held by you. This distribution of long-term capital gains is subject to a maximum tax rate of 20 percent; the Fund made no distributions subject to a maximum tax rate of 28 percent.

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Needham Funds

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1-800-625-7071

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Executive Vice President
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Peter J. R. Trapp

Directors
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John C. Michaelson
Roger W. Johnson
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F. Randall Smith

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Agent and Transfer Agent:
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