VALUE CONTRARIAN
ASSET MANAGEMENT

2016 Second Quarter
Value Contrarian Equity Fund

Dear Partners,

We derive no comfort because important people, vocal people, or great numbers of people agree with us. Nor do we derive comfort if they don't. A public opinion poll is no substitute for thought.

Warren Buffett
Buffett Partnership Letter
January 1965

True [investing] conservatism is only possible through knowledge and reason … I feel the most objective test as to just how conservative our manner of investing arises through evaluation of performance in down markets. Preferable these should involve a substantial decline in the Dow.

Warren Buffett
Buffett Partnership Letter
January 1965

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According to Larry Fink, head of trillion dollar asset manager Blackrock, there has been plenty of discussion concerning how the extended period of low interest rates has contributed to inflation in asset and stock prices. But, not nearly enough attention has been paid to the toll these prolonged low and negative interest rates are affecting the ability of investors to save and plan for the future.

As a result of low and sub-zero yielding government debt in Japan and Europe, many investors are being forced to buy riskier corporate bonds and longer-dated maturities. Closer to home, we also see this increasingly desperate search for yield in the face of rock bottom GIC rates.

As a result, at VCAM we are receiving more inquiries regarding potential investments in our Fund. Low interest rates are forcing investors hungry for better returns, and higher yields, to consider alternatives such as the stock market. The problem with this hot "new money" is that many "GIC Refugees" are not true believers in the wonders of compounding long-term equity returns. At the first sign of a major recession, a surge in inflation, or an unexpected rise in interest rates, investors will likely send this "hot" new money back to their GIC bunkers.

It has always been our preference to find long-term, patient capital for your Fund. Yes, we could be a larger fund if our salesmanship did not point out to prospective investors the real possibility of experiencing periods with severe wind shear and negative returns. In our experience, upfront transparency is the best policy. A stable, long-term shareholder base is our primary goal.

We are proud of our long-term shareholder base and very low turnover rate. We are rooting for all our investors to live at least until the ripe young age of one hundred and five!

Second Quarter Performance

> **It took Charlie Munger to break my cigar-butt habits [buying crappy businesses that are statistically cheap] … The blue print he gave me was simple: Forget what you know about buying fair businesses at wonderful prices; instead, <u>buy wonderful businesses at fair prices</u>.**
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> **Warren Buffet Speech**
> **April 14, 1994**

Your Fund ended the second quarter with a net asset value of <u>$3,220.15 per unit</u>, an increase of <u>$62.54</u> from the December 31, 2015 net asset value of <u>$3,157.61 per unit</u> (after distribution). Year-to-date six month performance: 2.0%.

Over multiple year periods, your Funds investing results are determined by the <u>underlying results of the businesses we own and the prices paid</u> to buy these businesses. The availability of a stock market quote is merely an advantage to be utilized, allowing us to be buyers at times when others are <u>fearful</u>.

During the month of June, an excellent example of this buying philosophy was the brief but sharp <u>Brexit selloff</u> in global, and in particular, European stock markets.

As a result of this short-term panic, your manager took a position in Europe's strongest economy, Germany. Through the iShares Germany ETF, we gained immediate exposure to a blue chip index of large and mid-sized German companies. When our purchases were made, this ETF was down approximately 15% for the year. Bayer, Siemens, SAP, BASF, Allianz, Daimler and Deutsche Telecom are the top holdings in this blue chip index.

Contrary to popular opinion, we view the acceptance over the past year of one million new refugees into Germany as a medium to long-term positive for their economic growth. Yes, some short-term pain is necessary for long-term gain.

Countries or cities which experience a sustained population influx, very often do economically well in the long-term. These new immigrants send their children to schools, necessitating the building of new housing, and all the ancillary purchases growing families make every day. Vancouver, Toronto and Israel are just three examples of jurisdictions which have benefited economically from a history of population influx.

Thus, we are long-term bullish on Germany. In the meantime, this Fund yields 2.3%.

During the quarter, we added to our position in General Electric and took an opening position in First Date Corporation, a leading payment processing firm which is still highly leveraged from a previous leveraged buyout.

Metals, mines, gold, energy and telecom stocks are what has been powering the TSX Index this year. Other than energy stocks and our TSX 60 holding, your Fund has never been a big commodity investor.

Another headwind your Fund has faced results from our exposure to the U.S dollar. From .72 cents at the end of December, the Canadian dollar finished the second quarter at .77 cents. As we have approximately 50% of our portfolio in U.S stocks and cash, this has negatively affected our returns to date. But we are not complaining, as last year this situation helped us produce positive returns when the index was down almost double digits.

Barring a Donald Trump surprise win-correction, the bull market continues on, albeit with much lower conviction and market breadth (ie: fewer sectors/ stocks making 52 week highs).

OUTLOOK

> **A man you can bait with a tweet is not a man we can trust with nuclear weapons.**
>
> **Hillary Clinton**
> **July 2016**

> **If a 20% or 30% drop in the market value of your equity holdings is going to produce emotional or financial distress, you should simply avoid common stock type investments. In the words of the poet – Harry Truman – "If you can't stand the heat, stay out of the kitchen".**
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> **Warren Buffet**
> **Buffett Partnership letter**
> **January 1965**

The good news is that the occasional market drop (think Brexit), is of little consequence to long-term investors. Preparing yourself psychologically to shrug off the next downturn is an important investment behavior, as no one with certainty (including us), knows what the market is going to do month to month or year to year. What matters is where you start and where you end up. Shuffle around the order of the plus and minus years, and you still come to the same ultimate result in the end.

The historical facts of the stock market irrefutably demonstrate that, <u>the overall trend is up</u>. As long as a severe 20-40% drop isn't going to somehow cause an investor to panic and bail out at low prices, one will do pretty well in stocks over a

10-15 year period. And likely even better if an investment is made with a Fund manager who has a considerable chunk of his/hers wealth invested alongside that of his investors. It's not such a bad idea when your manager slurps from the same bowl of hot & sour soup as all his investors.

Obviously, a Trump win could easily precipitate a 15% autumn stock market correction. However, unless Hillary commits some horrendous blunder, we don't see a Trump presidency. At the end of the day, we assume enough voters will bite their lips and common sense will prevail (let's hope).

On the back of firming commodity prices and low interest rates, the TSX will likely continue to outperform in 2016. The major risk, as always, would be an unexpected rise in long-term interest rates. Bull markets rarely die from too much skepticism.

Respectfully yours, **

Benjamin D. Horwood
Portfolio Manager
August 8, 2016

P.S. Do visit us at our **NEW** web site: www.valuecontrarian.com

**We're often asked: "When is the best time to invest in the Value Contrarian Fund?" Although there is no best time, since it is impossible to time the market, a preferable entry point is when the Fund has produced a month of negative returns or a year of underperformance. Unfortunately, human nature prefers the exact opposite.

Overall, long-term shareholders in the V/C Fund benefit from a sinking stock market, the same as a regular grocery shopper benefits from declining food prices. So when stock markets plummet – as they will from time to time – "neither panic nor mourn". It's good buying news for your Fund.