VALUE CONTRARIAN
ASSET MANAGEMENT

2013 Third Quarter
Value Contrarian Equity Fund

Dear Partners,

> **Because the returns on "safe" investments are so low today, people are moving further out on the risk curve to pursue returns that meet their needs… I've written often about the tendency of people to accept lower returns, high risk and weaker terms in order to deploy their capital in "hot" times. The (investments) they make get worse, and that makes investing riskier and less profitable for everyone (The race to the bottom).**
>
> **Howard Marks**
> **Oaktree Capital**
> **January 2013**

> **It's relatively easy to make good investments when capital is in short supply relative to the opportunities (i.e. think bear markets) and investors are reticent. But when there's "too much money chasing too few deals", investors compete to put (their cash) to work in ways that are injurious to everyone's financial health.**
>
> **Howard Marks**
> **Oaktree Capital**
> **January 2013**

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When cash deposits pay virtually zero, investors have an incentive to take risks in search of higher returns. That has been good news for the junk (high yield) bond market. Low rates will not last forever, so naturally companies are keen to take advantage of what might be a fleeting opportunity.

Today, companies (borrowers) are once again using esoteric structures along with a host of riskier borrowing practices associated with the leveraged buyout boom that helped inflate the 2005-2007 credit bubble. Last time (prior to the credit crisis) Wall Street came up with CDOs… packages of pooled subprime mortgages rated as triple A… This toxic "junk" was found in all sorts of investment products as we now know (remember ABC paper?).

Recently, there has been the issuance of junk bond PIK-toggle notes. These instruments give the junk bond borrower the option to pay lenders with more bonds instead of cash if they run into financial trouble. Good news for the borrowers, but perhaps a foolish move on the part of the junk bond lenders!

The question experienced and savvy fixed-income investors (lenders) are starting to ask is whether these are warning signs of the return of "toxic" practices and overheating in the credit markets (last seen prior to the start of the 2007 credit crisis).

As credit yields appear likely to remain extremely low for an extended period (maybe 5+ years)… the question remains what type of "riskier" fixed-income investments will Wall/ Bay Street come up with to satisfy the appetite of retail investors/hedge/pension funds for higher returns.

A perfect example is the recent TSX public offering of a fixed-income fund with the comforting title: "Senior Secured Floating Rate Loan Fund". This Fund is courtesy of CIBC – National Bank, RBC Capital, TD Securities and all the rest. The public offering prospectus is over 70 pages long. However, an investor only discovers at page 20 that "the average rating by S&P of the Indicative Portfolio is B+".

What's the significance of a B+ rating you ask? I quote from page 20 of the prospectus: "Loans that are rated 'BB+' and below by S&P or Bal and below by Moody's are

considered to be **non-investment grade loans**…. And are considered by rating agencies to be **speculative and subject to high credit risk**". Funny how the title of this new investment Fund being flogged to Canadian retail investors never mentions the word "junk" or "high-yield". At a sizeable discount, this could become an interesting investment.

Bottom line: Be wary of Wall/Bay Street bearing high-yielding gifts… or, get in early before the crowd. But make sure to time your exit well.

Third Quarter Performance

Your Fund ended the third quarter with a net asset value of $2,844.80 per unit, an increase of $317.36 from the December 31, 2012 net asset value of $2,527.44 per unit (after distributions). Year-to-date nine month performance: **+ 12.5%**.

In the second quarter Value Contrarian Fund letter I wrote: "In 2013, the TSX Index has been one of the industrialized world's worst performing markets. The recent two year underperformance of the Toronto stock market leads us to believe we are due for a year of catch-up."

On a more pleasant note, the TSX has gone from flat performance in 2013 to up over nine percent since June. We often see last year's laggard Index's become next year's outperformers. My view is that the TSX is more likely to surprise on the upside in 2014.

Finally, Christmas/Hanukah has come early (November) to the V/C Fund. Jonathan Goodman and his family (as controlling shareholders) have created a massive amount of wealth for your Fund through Paladin Labs. Paladin is a Quebec based specialty pharma company focused on the acquisition, in-licensing, marketing and distribution of pharmaceutical products.

No need for "high risk" research and development programs looking for the next blockbuster drug. Rather, Paladin initially ground its way to fabulous shareholder wealth creation by avoiding "sexy", and instead looking for singles and doubles – the unwanted castoffs of the major multinational pharma companies. "Give us your

unwanted – unloved – too small for us – products" should have been the Goodman's moto!

Last week, Jonathan and the Goodman family decided to sell Paladin. Not only have they become fabulously rich ($700,000,000+) but so did those who stuck around for the ride – including the Value Contrarian Fund! Our initial purchases were made in 2001 and 2002 ($3.63 - $4.99). Today the stock is trading at $104. That's called a "twenty+ bagger". Thank you/Merci Jonathan!

OUTLOOK

It's been another quarter of the old adage, "don't fight the Fed". By that we mean as long as the Fed has no intention of raising short-term interest rates, then there is little resistance to impede the markets from moving higher.

Even the laggard TSX Index has gone from negative returns earlier in the year, to up over nine percent since June (recently even outpacing the sizzling S&P 500).

We often see last year's laggard Index's become next year's outperformers. Barring a global geo-political event, my view is that the TSX is more likely to surprise on the upside in 2014.

Respectfully yours,**

Benjamin D. Horwood
Portfolio Manager
November 8th, 2013

P.S. Do visit us at our 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 news for your fund.