VALUE CONTRARIAN
ASSET MANAGEMENT

2011 First Quarter
Value Contrarian Equity Fund

Dear Partners,

"Americans can always be counted on to do the right thing after they have exhausted all other possibilities." (Winston Churchill)That seems to capture the attitude of the bond market today. It trusts our leaders to get the government's fiscal house in order…But such confidence in American rectitude will not last forever…I don't know how long we have before the bond market turns on the United States.

Gregory Mankin
Harvard Economist

"When do you generally get action (ie: spending reforms) from governments? When their bond market blows up."

Stanley Druckenmiller
(Former associate of George Soros)

But every time we give free money (ie: QEI+II) to lots of people who are very, very smart and know how to use it, you'll end up with a bubble or a nasty problem that we don't quite see in front of us.

Jack Welch
Former CEO G.E.
May 2, 2011

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Your fund ended the first quarter with a net asset value of $2,550.34 per unit, an increase of $134.34 from the December 31, 2010 net asset value of $2,416 per unit (after distributions).

QE-II will be completed by the end of June. The consensus opinion seems to be that interest rates will be headed higher because uncle Sam will no longer be buying U.S. treasury bonds which artificially kept rates low. However, U.S. long bond yields have actually fallen over the past couple of weeks. Historically, yields also fell after the first QE-I program was completed. If, over the next 12-18 months we are entering a period of slower economic growth, long term interest rates should remain benign.

What is troubling today is that the U.S. long bond market is not sending any "yellow" or "red" flashing signals that America has to start addressing its deficit/fiscal problems. Today's rock bottom 10 year U.S. treasury yields (3.1%) represent the calm before the next storm. Unfortunately, nobody knows when that storm will hit.

Housing stocks and home prices peaked in 2005, nonetheless, it took more than 2 years (2007) before investors felt real pain in these investments. Likewise, today's interest rate environment may last longer than most fix-income investors contemplate. But eventually, there will be an unexpected/surprise day of reckoning along with much higher long-term interest rates.

Today, China appears to be in a catch-22 situation. One of Beijing's greatest fears is that popular discontent over inflation could spark a wider protest movement. One of the medicines to combat inflation is higher interest rates. However, the difficult balancing act the Chinese face is to cool prices without choking-off economic growth or creating unforeseen social unrest.

To understand how difficult it is both politically and economically to slay inflation once it has taken hold, I urge you to read: "The Great Inflation and its Aftermath" by Robert J. Samuelson. The author chronicles the rise, root causes and medicine needed to beat inflation in America over the 1960-1982 period. Samuelson clearly demonstrates how there is no painless method to tame inflation once it has taken hold.

Samuelson also explains a key element most people fail to understand about inflation. Simply stated, government intervention policies which attempt to hold unemployment below its "natural rate" creates inflation. If, for example, the natural unemployment rate today was 7%-8%, then trying to bring the American unemployment rate below 7%-8% could actually be inflationary, despite millions remaining jobless!! High unemployment

and excess industrial capacity does not automatically translate into a low inflationary environment as many commentators would have us believe.

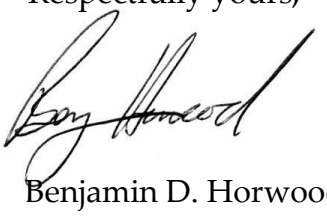
Here is another interesting tidbit concerning inflation. Politicians want to get re-elected so they will usually oppose any economic (inflation- fighting) decisions which risk restraining growth or cause higher unemployment. Inflation grows because democracies often fail to practice economic self discipline (advantage China).

To cure the double digit inflation North Americans endured in the late 1970's and early 1980's required a massive recession due in large part to Fed Chairman Paul Volkers "shock treatment". This period showed that one cannot quell high inflation without serious social disruption. (Remember 10% unemployment and 13% mortgage rates?)

At the end of the day, printing (borrowing) money to fight major wars, whether they be military, economic, or social is at the root cause of inflation.

It will be interesting to see how American and Chinese politicians navigate the treacherous tides of inflation. Any massive slowdown in China (whenever it occurs) would not be beneficial to Canada's commodity based economy or Vancouver real-estate. Such a scenario would likely be more helpful to our resource hungry American neighbors. Never count the Americans out of the game! Eventually Afghanistan and Iraq will be just a bad dream and oil will be under $75 a barrel. In the meantime, our smart Canadian clients are buying U.S. real estate. Congratulations!

Respectfully yours,



Benjamin D. Horwood
Portfolio Manager
May 20, 2011