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2000 Third Quarter
Value Contrarian Canadian Equity

Dear Investors,

> ***Investing was never meant to be exciting. It was never meant to be recreational. It was never meant to be the stuff of talk shows. So it won't be the stuff of cocktail party conversations any more. And that's fine. It was meant to be where you put money for future needs.***
>
> ***Edward Kerschner***
> ***Investment Strategist***
> ***Paine Webber***

> ***Before this shakeout is over a lot of jobs will be lost, a lot of space will be empty and a lot of Internet infrastructure will be repossessed or auctioned. Morgan Stanley may even go back to suits and ties.***
>
> ***Barton Biggs***
> ***Morgan Stanley***

Wipeout! Meltdown! These are the two words that can best describe what's happened to the tech and telecommunication sectors over the past six months. The rotating bear market has struck these two sectors with a vengeance. First the foot soldiers cracked in late spring and now the mightiest generals have fallen. Lucent, Motorola and Nortel have all dropped more than 50% from their 52-week highs. What happened and why? Let's take a closer look at Canada's supernova stock- Nortel Networks.

We all recognize in the investment community that Nortel is a fast growing company, on the cutting edge of the fiber optics revolution. Simply stated, prior to the recent sell off, the stock, according to industry terminology, was "priced for perfection". When a growth stock is trading at 80-100x earnings, there is no mercy shown should there be the <u>slightest</u> hint or whiff of a slowdown (or heaven forbid a short fall) in sales/ earnings or even <u>expected</u> sales/ earnings. Any perceived negatives can lead to <u>instant and severe punishment</u> by the stock markets. And that's what occurred to Nortel's stock over the past weeks when sales expectations were <u>slightly</u> disappointing.

Nortel is highly profitable and a great Canadian success story. However, over the past year, as a result of its high valuation, it has been at times a high risk/ gambling stock and not necessarily a conservative investing stock (high risk = 35-50 P/E gambling = 50+ P/E).

Going forward, Nortel will continue to dominate the TSE 300 Index. Volatility in Nortel's share price will have an outsized influence on the Index's returns. As the price-earnings ratio on the stock declines, hopefully so will its volatility. But since Nortel is such a large component of the Index, most Canadian fund managers and other foreign professional investors feel they have to own the stock. Their quest for short-term performance often leads to mass lust or distain for the stock, hence huge daily volatility.

The past several months of collapsing high-tech stock prices have revealed the folly of this insane approach of chasing what's "hot", while turning a blind eye to ludicrous valuations. Over paying for "growth" stocks can indeed be a dangerous game. (For the record, as "contrarians" we recently purchased an opening position in Lucent Technologies.)

Third Quarter Performance

Your fund ended the third quarter of 2000 with a net asset value of $1,687.89 per unit, an increase of $226.43 from the December 31, 1999 asset value of $1,461.46

Rising oil prices and falling long-term interest rates were two factors positively affecting your Fund's portfolio. On the negative side, Japanese stocks have slipped back into a bear market.

With the implosion of the tech and telecommunication sectors, many investors have returned to the safety of "old" economy stocks. Once again stocks with earnings predictability, free cash flow, moderate growth rates, and reasonable valuation levels have gained new found respect. Our holdings of Saputo, Molson, Quebecor World, and Canadian banks stocks fit this bill. Unfortunately, forest product stocks remain in the doghouse.

While the stock market is full of good value, many of these cyclical stocks are "value traps". Many "value" stocks will remain cheap or become bigger bargains. This will only change when it becomes clear that a recession is under way and expectations of a new economic cycle are in the air. Thus, while Ford, Daimler and GM are cheap today, they will not have bottomed until they start to lose tons of money and the "R" word is out in the open.

During the quarter we increased our holdings in Bank of Montreal, Saputo, Bristol Myers, White Mountain Insurance, and Dun & Bradstreet. Subsequent to our purchase of Bermuda-based White Mountain, Warren Buffett revealed a 20% interest in the company (always a positive endorsement for a company and its management).

New holdings added during the quarter included First Data, a global leader in electronic commerce and payment services. The company is the world's largest third party credit card processor, and also owns the Western Union money transfer business. The company is highly profitable and will produce over $900 million in free cash flow this year. First Data is also positioning itself to participate in the growing e-commerce transaction processing business.

Associated Freezers is another new holding that caught our attention when it announced a merger with Atlas Cold Storage, becoming North America's third-largest operator of public refrigerated warehouses. T.D. Capital agreed to make a $35 million investment in the merged entity. More importantly, Associated gained the superior management skills of the Atlas team. The stock yields 11.5% (providing downside protection), and has excellent growth prospects under the entrepreneurial leadership of president Pat Gouveia. We also like the fact that Pat, by rolling his assets from Atlas into Associated, becomes a major shareholder. His financial interests are thus directly aligned with ours.

Outlook

> **Bull markets (in their late stages) depend much more on the performance of just a handful of large-cap names rather than the overall number of stocks rising versus those that are falling… The Stock Market <u>is not</u> a democracy. It's an oligopoly whose behavior is determined by fortunes of the major players…**
> **The grunts don't matter much in the big scheme of things. Until the generals falter, the advance will continue.**
>
> **Jeff Rubin**
> **Director Research**
> **Birinyi Associates**

If it walks like a bear, smells like a bear and growls like a bear, then perhaps it is a bear! But don't expect anyone in the investment community to scream bear – that would be bad for business.

Basically, we've been in a <u>rotating bear</u> market since early 1999. From the spring of 1999 to the spring of 2000, old-economy stocks were trashed. Since March of 2000, old economy <u>"value"</u> stocks have been <u>resurrected</u> while tech stocks have crashed, as witnessed by the over 20% decline in NASDAQ so far this year.

Basically the market is sending us signals that all is not well. The spate of profit warnings this past quarter suggests a fundamental weakening in the economy.

The other day, Daimler Chrysler reported a third quarter loss. This is a significant signal since a slowdown in the auto sector has widespread ramifications, especially for Ontario and to a lesser degree Quebec. Rockwell, the US automation and avionics company, claims 60 automobile plant projects have been deferred or delayed amid signs of slowing growth in the North American car industry.

Although not a certainty, a mild recession is a definite possibility within the next 18 months. The first quarter of 2001 will likely provide key technical indicators as to the future direction of the stock markets. A key positive will be if the Dow can surpass its record high of 11,750 set back in January of 2000.

On a more positive note, it appears that both the Federal Reserve and the Bank of Canada are finished raising interest rates. Inflation remains under control and bond yields should continue their downward trend – all of which is positive for the mortgage and housing markets. Finally, the recent drop in capital gains taxes can only be interpreted as good news for the stock markets and over-taxed Canadians. And, of course, Canadian bank mergers loom ahead, most likely during the 4th quarter of 2001.

Respectfully yours,**

Benjamin D. Horwood
Portfolio Manager
October 31,2000

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