VALUE CONTRARIAN ASSET MANAGEMENT
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2000 Year-End
Value Contrarian Canadian Equity

Dear Investors,

> ***At a cocktail party or reading the newspaper or watching CNBC, all they talk about is price: " What's the stock trading at?" No one ever says, " What's it worth?"***
> ***When you buy your house, you say, "what's it worth?" … You really just grind away trying to figure out what's it worth… But boy, people looking at publicly-traded equities never seem to ask that question.***
>
> ***Mason Hawkins***
> ***LongLeaf Partners***

> ***It is just devastating … I did not load up on dot-coms. I picked good, solid blue-chip tech stocks –Intel, JDS Uniphase, AT&T Corp, Lucent Technologies, Sun Microsystems, WorldCom Inc. " Now, I don't know what to trust."***
>
> ***James Garfinkel***
> ***Retail Investor***

We all know the old adage that for success in the real-estate market, it's location, location, location. But in the stock market, a key element is valuation, valuation, valuation (in addition to diversification).

Mr. Garfinkel, as the above quote illustrates, may have purchased so-called "blue chip" tech/telecom investments. Nonetheless, in the end he lost big-time by failing to ask "what's it worth". Only by asking the latter question can an investor avoid paying an inflated price.

Over the past year, many investors suffered sickening drops to their so-called solid blue chip investment portfolios. Obviously, investing is not as simple as just buying blue chip growth stocks at any price. As Buffett states, "in the end, valuation counts."

Many were not really investors, but rather momentum players chasing rising tech, media and telecom stocks. No attention was paid to asking the following three simple questions:

1) What's it worth?
2) Am I overpaying for this stock?
3) What's my downside risk should earnings growth falter during an economic slowdown/ recession.

Just like a baseball player can refuse to swing at a poor pitch, investors can refuse to bite when a company's share price becomes inflated by unrealistic expectations or "irrational exuberance". Unfortunately, without the skills to put an approximate valuation on a company, most investors are flying blind.

The last couple of months have also shown that economic cycles affect almost all business sectors. The belief that tech or internet companies are immune to the normal ebb and flow of the economy is pure bunk! Moreover, "technological revolutions" are no guarantees of stock market riches without either of those old-fashioned, "old" economy traits of rising cash flow or earnings.

2001 Prediction

Investors, chasing returns (buying what has worked in the recent past), will over-indulge in Canadian bank and insurance stocks, sending P/E ratios to the high end of their historical norms. The excesses in 2001 will be transferred from tech to the financial service sector of the TSE.

Eventually, the fear of rising credit problems will overpower the positives of falling interest rates for the banking sector. The end result will be the same for momentum players who came late to the banking and insurance party.

Finally, the stock markets will bottom only after the Dow and S&P 500 experience a bear decline of at least 20 percent from their all-time highs (so far only NASDAQ is in bear territory). Greenspan's rate cuts will eventually work their magic, and certainly curtail the impact and duration of the looming slowdown / recession. History has shown that stock market bottoms are reached well before the end of a recession or slowdown.

2000 Performance: +18.2%

January 1, 1997	–	$ 1,000.00 (inception NAVPS*)
December 31, 2000	–	$ 1,727.41
December 31, 2000	–	($104.64) distribution per unit
December 31, 2000	–	$ 1,622.77 (NAVPS after distribution)

Your Fund ended the year with a net asset value of $ 1,622.77 per unit, after having declared a distribution on December 31, 2000 of $104.64 per unit.

Your distribution was reinvested in additional units. These new units will appear on your December 2000 statement.

During the past year our cautious approach served us well. This period was marked by extreme volatility in the financial markets. Despite our large cash holdings, there were five separate months in which your fund incurred negative returns. The absence of a direct holding in over valued Nortel also helped us immensely during the final quarter of the year.

The smartest (lucky) move made during the year was to unload the bulk of our Japanese holdings. Unfortunately, this was the main cause of our large year-end capital gains distribution.

We also profited immensely from the Canadian life insurance IPO's. Right at the peak of the technology stock mania in March, Sunlife went public. Priced at below its book value, Sunlife has since more than doubled in value.

Moving from "swans" to "dogs", we sold our position in Domco after it became apparent that merger benefits with Tarkett were merely a mirage. Sometimes bargains have the bad habit of becoming much bigger bargains (one of the many pitfalls of the trade).

We continue to have a bias against deeply cyclical resource stocks (the exception being oil + gas), because they have generally been poor long-term investments. Thus we dumped losing positions in Abitibi and Alliance Forest.

If you see us dabbling in "tree, rocks and water" again, please take us aside and scream loud and hard. We strongly suggest that investors who want exposure to these sectors purchase a natural resource specialty fund.

We continue to have large cash reserves and expect to judiciously deploy these assets in the American and Canadian Markets in the coming year. The economic slowdown/recession has the positive effect of taking the "irrational exuberance" out of stock market valuations. We remain highly optimistic despite the pessimistic headlines. However, continued volatility can be anticipated.

* Net Asset Value Per Share

The Year Ahead – 2001

> ***This is turning into a classic slowdown in global economic activity, led by central-bank tightening and pushed further down by higher oil prices. The last three recessions were caused by central-bank tightening and oil shocks, and we've got them (both).***
>
> ***Nancy Lazar***
> ***International Strategy***
> ***Investment Group***

The year 2000 demonstrated that you don't need a recession to have a rotten year in the stock markets. Soft landing, hard landing, or whatever, speculative excesses and overvalued stocks eventually get cut down to size.

Presently, corporate profits are being squeezed by a combination of higher oil prices, past interest rate hikes, and slowing sales. The slower pace of economic growth in 2001 might feel like a recession after the past couple of years of strong growth. Also, the economy will likely appear worse than the real numbers due to the ongoing "doom & gloom" headlines.

Alan Greenspan's initial rate cuts in early 2001 may create powerful short-term stock-market rallies. On the other hand, just as the soaring NASDAQ chose to ignore the negative effects of Greenspan's rate hikes from June 1999 until March 2000 (NASDAQ peak) –likewise, the markets may for a period of time shrug-off the positives of any early rate declines.

Perhaps most important, the major stock indexes are still priced quite high despite the losses of last year. The market may not be able to produce a sustainable rally like it has following past rate cuts. Captain Greenspan is also not infallible. Remember, a series of rate cuts starting in June 1989 failed to prevent the bear market of October 1990 and ensuing recession.

However, the outlook isn't all bleak. There are many undervalued small-cap stocks to be had. Eventually, a series of rate cuts from the Federal Reserve will create a floor for equity prices. Before that happens, we would not be surprised to see the Dow and S&P 500 slip into bear-market territory later in the year.

In the year ahead investors must be prepared to psychological tough-out the inevitable deluge of profit warnings, scary economic news, and unexpected financial crises. When the air smells sweet, stock market bargains are much harder to find. "Don't believe all the hype at the top, or all the gloom at the bottom."

Value investors will again rejoice in 2001!

On a lighter note, perhaps value investors can take the comments of Barrons columnist, Alan Abelson, with a chuckle: " The expiring year (2000) taught us how to respond to those full page ads from brokerage houses urging one and all not to panic. When you see one of those solemn pitches from the wonderful folks who brought you the likes of Vertical Net (high 148, now 7), Bluestone Software (high 155, now 15) or Yahoo (high 250, now 30), do yourself a favor – panic, man panic."

Management Note

> ***Most investors are only interested in chasing (short-term) performance. They don't care whether you outperform in the long run or not.***
> ***I'm a Buffett emulator… and even if it's not the most popular style, I will persist. I hate to say clients be damned, but you have to believe in something, and this approach makes the most intellectual sense to me.***

Edwin Walczak
Portfolio Manager

As we have always stated in the past, we cannot promise any particular results, only that investments for your fund will be selected based on value, not popularity. Our goal is to keep permanent loss of capital to a minimum, the upside will take care of itself.

Being the largest shareholder and manager of your fund is certainly no guarantee of superior long-term results, but it may raise your comfort level having my financial interest aligned with yours. We would like to thank our shareholders for their continued support during the past year.

Respectfully Yours,**

Benjamin D. Horwood
February 1, 2001

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?" 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.