2003 First Quarter
Value Contrarian Canadian Equity

Dear Investors,

> ***The Faustian (American) bargain of political and military support for autocratic regimes in exchange for free access to oil is no longer sustainable; what was seen as a bolster to regional stability is now clearly a source of (Arab) hostility and terror.***
>
> ***Mark Leonard & Conrad Smewing***
> ***Public Diplomacy in the Middle-East***

> ***One reason (Arab) hostility towards the west is so strong is that people living amid poverty, high unemployment and political repression do not have their freedom to protest about problems close to home. Discontent is deflected toward the west and … western foreign policy, particularly towards Israel and Palestine …***
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As history has shown, Iraq is a dangerous neighbourhood given its tribal, ethnic, religious and political "patchwork". The Americans and British will need staying power and allies to win the peace.

The prospect of Arab dictatorships collapsing as a result of domestic street mobs opposed to the Allied war on Iraq looks fairly remote – especially in light of the region's history. Mid-East observer Roula Khala notes that: "In spite of huge oil wealth, per capita economic growth in the Middle East lags behind the rest of the developing world. Education systems have been hijacked by Islamists; civil society is repressed; political organization is stifled."

Only time will tell if the American led war on Saddam Hussein kick starts a mid-East "domino" of new governments which are not based on corruption and repression. The US pressures for reform are immense. Militarily, the coalition so far has been successful in Iraq.

The danger is that politically mishandled "Iraq has the violent capacity of many Lebanons". Winning the peace and rebuilding Iraq will be the hard part of this campaign. The coalition must be seen as peacemakers, otherwise they could end up being treated as just another militia.

The eventual resolution of the long-standing Palestinian-Israeli dispute (yes, we may be overly optimistic) will serve to highlight the many other festering domestic tensions in the region. Although not widely reported, in an April 12th interview, the Israeli Prime Minister optimistically stated that: "… opportunities have currently been created that did not exist before …. There is therefore a chance to reach a [peace] agreement faster than people think." In fact, a peace agreement between the Israelis and Palestinians may come back to haunt the regions entrenched regimes/dictators.

High oil prices (over $30.00) continue to be one of the greatest threats to the North American economy. The major negative economic impact of the Iraqi war has been on oil prices. During the first quarter of 2003 the U.S. benchmark crude averaged $34 a barrel. A year earlier, the U.S. benchmark crude was $12 lower. This has been a heavy tax for both consumers and corporations. Every one of the global downturns over the past 30 years coincided with a surge in oil prices. Subdued first quarter/03 corporate profitability should not be a surprise.

However, on a positive note Iraq's southern and northern oil fields are now under Allied control. Nor have shipments been disrupted from Saudi Arabia, Kuwait or Qatar. In addition, Venezuela's exports are recovering, and spring weather in Europe and North America has reduced the demand for winter heating oil.

From a 12 year high of $39.99 a barrel at the end of February, oil prices have eased to under $30.00. Watch for oil prices to retreat to the $24-$28 level, a key ingredient needed to aid in the sustainability of future economic growth and corporate profitability.

First Quarter Performance

Your fund ended the first quarter with a net asset value of $1,543.12 per unit, a decrease of $98.12 from the December 31, 2002 asset value of $1,641.24 per unit.

Although the major stock indexes bottomed in early October 2002, the first quarter of 2003 produced three consecutive months of negative index returns. Our portfolio was not able to sidestep the effects of higher oil prices and the economic uncertainties affecting the American economy. A rising Canadian dollar also adversely affected our U.S. holdings as we report to you in Cdn dollars.

More specifically, negative profit warnings/surprises hit a number of our equities including Alcan, C.P. Rail, Quebecor World, Bank of New York, and Baxter.

That's the bad news. The good news is that during the first quarter new stock-market lows were not made. Most importantly, oil prices are now under $30.00. We feel more confident that the worst is over, and going forward positive quarter over quarter profit comparisons will be much easier to attain. Also, we are now seeing companies that fail to meet prior years profitability levels, yet don't experience a share price collapse. In other words, all the bad news is priced into the stock.

Our portfolio continues to be concentrated in three major areas: Healthcare, Financial Services, and Travel (hotels). These are three sectors we feel will experience not only growth over the next twenty years, but more importantly for shareholder value creation, "profitable growth".

Remember, Nortel and Bombardier produced lots of growth during the 1990s. However, none of that growth created shareholder wealth or sustainable profitability. For a more vivid illustration, one merely has to compare the stock price today of Nortel and Bombardier with that of 1993 to understand the concepts of creation or destruction of shareholder wealth. All too often investors are mesmerized by the "G" (growth) and forget the key element of "P" (sustainable profits).

During the quarter we trimmed our positions in Bell Canada and the TSX/S&P 60, in order to add to our long-term holdings of Fairmont hotels. With the threat of terrorism, the Iraqi war, economic slowdown, and now the SARS-scare, Fairmont is a classic "contrarian" investment. We initially started accumulating the shares after the 9/11 attack in 2001.

While the stock is not super cheap, it provides a way to gain long-term exposure to profitable growth in the travel industry, through the ownership/management of irreplaceable hotel/resort properties. Fairmont's underleveraged balance sheet also enables them to make opportunistic acquisitions during these troubled times in the hotel industry. Potentially the SARS scare in the Toronto market, combined with a weak upcoming second quarter profit outlook, will enable us to further add to our holdings of this core position.

Barring sustained high oil prices, we remain optimistic for the remainder of the year and expect to generate positive returns in the coming quarters. And this summer don't forget to get out and travel. But make sure to stay at a Fairmont Hotel/Resort!

Outlook

> ***Imagine that the market, like a pendulum, swings between the extremes of investment sentiment – call them 3 o'clock and 9 o'clock. "At 3 o'clock, fear takes over and it's full panic," … "At 9 o'clock, greed takes over and it's full manic. At 6 o'clock there's a point where logic and balance exist and where valuations make a lot of sense to most rational people. Unfortunately, the pendulum doesn't spend much time at 6 o'clock."***
>
> ***James Grant***
> ***Grant's Interest Rate Observer***

Falling oil prices will likely rescue the North American economies from the clutches of a potential economic downturn. The securing of all Iraqi oil fields has raised hopes that the country could return to its pre-war production levels within the next 12 months.

The bear market in "value stocks", which commenced September 11 2001, appears to have made its final gasp in early March 2003. However, the major indexes bottomed in October 2002. The stock market valuation bubble, and orgy of overinvestment of the late 1990s, has made this bear market particularly brutal in terms of percentage decline and duration. It takes time to cleanse the system of these "bubble" excesses. September 2003 would represent a duration of two years for the bear market in value stocks.

In our estimation, barring unforeseen surprises, this part of the economic cycle has seen the worst of the stock market downturn. Only the next major recession will, in hindsight, tell us if October 2002 was really the bear market bottom.

The question remains how strong will economic growth be in the latter half of 2003? Certainly higher Canadian interest rates, and an artificially strong Canadian dollar, will take some of the wind out of this country's economic growth. But, with oil prices below $30.00 dollars, the American economy should show signs of a gradual sluggish uptrend by the second half of 2003. Our portfolio (healthcare, financial services, travel) is well positioned for the future. And as Buffett recently stated: " … occasionally successful investing requires inactivity."

Respectfully Yours,**

Benjamin D. Horwood
April 28, 2003

** 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.

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