VALUE CONTRARIAN
ASSET MANAGEMENT

2013 Year End
Value Contrarian Equity Fund

Dear Partners,

A bull market is like sex. It feels best just before it ends.

Barton Biggs
Former Morgan Stanley Strategist

In this business, you're wrong almost all the time. It's just a matter of degree, because nobody buys at the bottom or sells at the top.

Donald Yacktman
Yacktman Asset Management

The essential raw material for a bull market is cheapness, and that cheapness exists in stage one precisely because there are so few believers and so little confidence that… good times lie ahead. … Equally, in the third stage, there's too much confidence and too little cheapness. It's this imbalance that creates market tops.

Howard Marks
Oaktree Capital Management

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2013 Performance: +23.75%

December 31, 2012 – $2,527.43 (NAVPS after distributions)
December 31, 2013 – $3,127.63 (NAVPS)
December 31, 2013 – $219.89 (Distribution per unit)
December 31, 2013 – $2,907.74 (NAVPS after distributions)

Your Fund ended the year with a net asset value of $2,907.74 per unit, after a distribution of $219.89 per unit. Your distribution was automatically reinvested in additional Fund units (see your personal V/C Fund year-end statement).
The TSX Composite Index in 2013 returned: **+12.98%**.

There seems to be a persistent myth amongst certain investors that the Value Contrarian Fund is heavily overweight in Canadian bank/financial stocks. It's time to debunk this myth.

At year end, your Fund had 22.5% of its assets in Canadian bank stocks, yet the financial services sector of the TSX Index is 26.1% (30.8% for the entire financial sector). Interestingly, over the long-term (ten years+) Canadian bank stocks have outperformed the benchmark TSX Composite Index. Simply stated, Canadian banks are great businesses, characterized by high returns on equity, lots of free cash flow and a competitive business moat. The six Canadian chartered banks basically work as an oligopoly and suffer little from most foreign competition.

As a veteran investor once explained to me: "Ben, these stocks are like battle ships – every ten years or so they do something incredibly stupid and take a massive hit. Nonetheless, they just plow ahead despite their inevitable blunders."

A Canadian bank's mortgage business is like "the gift that keeps on giving." Canada Mortgage and Housing (a federal Crown corporation) insures all bank home mortgages in cases where the customer commits less than 20% to a down payment. The banks merely add this required insurance onto the customer's monthly mortgage payments. Indeed, banking is a nice safe business if you have the full weight of the Canadian government as your financial backstop in case the customer's mortgage goes bad.

True, if there is a major recession, the Canadian banks (which are basically a proxy for the Canadian economy), will take a hit. Nonetheless, 2013 produced another year of record bank profits and helped your Fund to outsized gains.

Paladin Labs, the Montreal-based pharma company (previously discussed last quarter), was a once in a lifetime "25X bagger." Our average Paladin cost, twelve years ago, was in the $4.50 range. In 2013, as a result of a takeover offer, the stock jumped from $41 to $118.
(We'll need a lot of good karma or a monumental miracle to uncover another 25X bagger !)

The U.S. component of your Fund also had a free foreign currency tail wind as a result of the falling Canadian dollar. A few years ago I made a strategic decision that a Canadian dollar at par is not the norm but an exception, a limited time offer with a quick expiry date.

We view our U.S. equity exposure as a key investment fundamental to the Value Contrarian Fund. Simply stated, the U.S. markets offer industry diversification and quality public companies that are just not available in Canada. Conversely, should the Canadian dollar drop below seventy cents, I would consider a conversion of U.S. dollars back into Canadian dollars.

The Fund's largest U.S. position, Berkshire Hathaway (8%), also had a stellar year, and there were no "blow-ups" in our foreign holdings. Obviously in 2014, we expect more subdued returns from our U.S. positions.

Avoiding permanent loss of capital (more than hitting the home-runs) is a key investment strategy that has greatly contributed to the long-term success of the Value Contrarian Fund. During 2013 we also avoided major blow-ups on the Canadian side of the portfolio. Unfortunately, two of our holdings, Strongco (construction equipment dealer) and Velan (valve manufacturer) demonstrated that stock values can become much bigger values when business fundamentals deteriorate.

In hindsight, neither of these two companies possessed a high ROE, excess free cash flow, or strong earnings predictability. These are fundamental attributes which normally pique our interest in a potential investment.

Buying on "value" alone usually can't overcome a company's poor financial performance and lack of long-term predictable earnings growth.

Outlook 2014

> **The one thing you could be quite sure of is if we went into some very major war, the value of money would go down… So the last thing you'd want to do is hold cash during a war… You might want to own securities… During World War II you know, the stock market advanced… You're going to be a lot better off owning productive assets (stocks, farms or real-estate) than you will by owning pieces of paper or I might throw in bitcoins.**
>
> **Warren Buffett**
> **March 3rd, 2014**
> **CNBC**

Absence a booming or vigorous economy, what would it take to see a significant rise in interest rates and inflation expectations? A major war. Governments rarely have a rainy day account stuffed with billions/trillions of dollars to pay for a war. Simply stated, governments borrow money (print money) to pay for costly military adventures. And what are the consequences? Borrow enough money and the financial markets will quickly start to worry about inflation and a devalued currency.

It's our hunch that it may take a major war to finally break the back of abnormally low interest rates. Interestingly, history has demonstrated that wars eventually lead to higher stock prices.

Today, the consensus opinion is that everyone expects interest rates to rise in the not too distant future. The contrarian position is that it might take a significantly longer period (five years+) before interest rates experience a significant rise. And if Japan is the template for rising interest rates – think twenty years plus!

2014 Global Military "Hot Spots" include:

- Israel/Palestine
- Iran & Proxies/Israel
- Korean Peninsula

- China/Taiwan
- Turkey/Syria
- Russia/Ukraine
- Saudi Arabia (civil war)
- Venezuela (civil war)

Bear markets (20%+ declines) normally occur as a result of some unexpected shock to the financial system or surprise geo-political event. Absent such a shock, 2014 should not be a bear market year for the Canadian or U.S. stock markets. Rather, an expansion in the P/E (Price-Earnings) multiple on stocks may further propel this bull market forward over the next two years as investors become more comfortable owning equities.

We also expect to see more volatility (i.e., 5%-12% corrections) throughout the year as stocks are fairly valued (as opposed to cheap during 2009–2011). After a few years of underperformance, Canadian equities could temporarily outshine our southern neighbour if oil & gold prices continue to surprise in 2014. Nonetheless, we still believe in the thesis that the long-term secular bull market in most commodities is over. In addition, the days of the Canadian dollar trading at or above par are likely not to be seen for many years.

Respectfully yours,**

Benjamin D. Horwood
Portfolio Manager
March 28th, 2014

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 buying news for your Fund.

It takes 20 years to build a reputation and five minutes to lose it.
If you think about that you will do things differently.

Warren Buffett

As we have always stated, we cannot promise any particular results, only that investments for your Fund will be selected based on **value, not popularity**. We view our Fund shareholders as our partners, and we assure you that the protection and growth of your capital will continue to be paramount in our thinking.

We aim not to be the biggest, but to ensure consistent performance, even if that means limiting the Fund's size or closing it to new investors in the future. We want to enjoy coming to work every day and view the Value Contrarian Fund more as a private partnership, where "membership has its privileges".

Secular or disruptive technological changes to an industry or company is what truly destroys shareholder wealth and keeps us up at night (think Nortel, Kodak or Blockbuster). Conversely, stock-market volatility or the fear and panic of a bear market are merely temporary but opportunistic events for the rational buyer. At the end of the day, "**price paid**" is what matters most.

Being the second largest shareholder and the manager of your Fund is certainly no guarantee of superior long-term results. But I do hope your comfort level is enhanced by having my financial interests aligned with yours. **Simply stated, your returns are my returns**.

We would like to thank our shareholders for the trust you have placed in us during the past year. And again, **thanks for your referrals** – much appreciated.

And a final thank you to the Value Contrarian staff - Chiraz & Jazz. We are most appreciative of their dedication in helping us achieve another successful year.

Benjamin Horwood