VALUE CONTRARIAN
ASSET MANAGEMENT

The greatest sign of appreciation you can show us is when you refer the V/C Fund to one of your friends or family members.

Kindly note, the Value Contrarian Fund may only be purchased once monthly.

Last Day for August Purchase*

August 25th 2015

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* **Cheques must be received by Tuesday, August 25th, 2015**

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VALUE CONTRARIAN
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2015 Second Quarter
Value Contrarian Equity Fund

Dear Partners,

If we get normal interest rates, stocks will look expensive.

We've done a lot of things that weren't in my Economics 101 class, and nothing bad has happened <u>except that people who've kept their money in savings (GIC's) have gotten killed.</u> ... We're operating in a world that Charlie and I don't understand.

Every company that employs an economist has one employee too many.

Warren Buffet
Berkshire Hathaway Annual Meeting
May 2015

To put it mildly, the TSX Composite Index has not had a stellar year. Year-to-date, the Index is in slightly negative territory. The <u>classic signs</u> of a late stage bull market are clearly present. The following are two flashing yellow signals that always make us sit up and take notice:

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1) Hot IPO's: Rolling The Dice With SPACs

Perhaps the best example of the hot IPO (Initial Public Offering) market in Canada has been the emergence of SPACs. (Special Purpose Acquisition Company)

SPACs are empty shell companies (aside from a small initial investment by the founders) whose sole purpose is to simply make acquisitions within 24 months of going public. If the SPAC comes up empty during its 24 month target search, shareholders get their original investment back. Five Canadian SPACs have gone public in the past year, raising close to one billion dollars of capital. The race is now on to find suitable acquisitions.

Obviously, when asset prices were much cheaper in 2009, 2010, 2011, and 2012, investors were not interested in taking a blind bet on a SPAC. But now that asset prices have doubled and tripled off the bottom, investors feel more comfortable "rolling the dice" with these "dream" vehicles.

Essentially, these are speculative investments. One is placing a bet on the individual "jockey" controlling the SPAC. The incentive, obviously, is to get a deal done. Price discipline could be the criterion that gets short shrift in the limited search time. Remember, failure to find an acquisition within the 24 month time frame results in losing the IPO capital.

As an investor, a better bet would be to initially remain on the sidelines. When the market cycle turns ugly, as it inevitably does, scoop up your favorite SPAC shares when they trade below liquidation value! Note, patience is required.

2) Lack of Breath: A Two-Tiered Stock Market

When just a few ponies are pulling the entire train (broad indexes) higher, this "narrowing" of the stock market is not a positive sign. In the newspaper, this would be visually apparent in the daily stock high/low section. For example, if seventy stocks made new lows, while only nine stocks made new 52 week highs, yet the indexes continue to hover near record territory.

This year, a winning Canadian stock in particular, Valeant, has been a prime example of one stock having an outsized influence in driving the TSX Index higher over the past twelve months.

Even as the NASDAQ was reaching new highs this year, other broad indexes, including those composed of transportation stocks or utilities, were trading well off their highs. Bottom line, a thinning roster of companies driving the indexes higher is a flashing sign of potential troubles (correction) ahead.

Second Quarter Performance

> **The multigenerational low in interest rates has driven a lot of people into stocks who would not normally be there. That money could exit the markets quickly once rates start to normalize.**
>
> **James Stack**
> **InvesTech Research**
> **August 16 2015**

Your Fund ended the second quarter with a net asset value of $3,146.16 per unit, an increase of $18.24 from the December 31, 2014 net asset value of $3,127.92 per unit (after distribution). Year-to-date six month performance: 0.58%.

The second quarter can best be described as one of "thumb sucking", or not much activity. Our cash position remains significant at 23%. We continued to cull the portfolio of overvalued companies or unnecessary risks. Going forward, we look to add to our energy holdings and specific emerging market ETFs. (Exchange-Traded Funds)

The lower energy prices spiral down, the more likely one or more of the various petro actors will blink. (i.e., Saudi Arabia/ Iran or perhaps a shocking debt default by a petro country or corporation) Also expect some high profile energy takeovers/ mergers.

Predicting the bottom in energy prices is not a science, but rather an art. Hopefully, the Economists magazine will grace its front cover with a classic contrary "buy" indicator.

As always, capital preservation remains key to our investment philosophy.

OUTLOOK

> **… Israel's core strategic doctrine is this: No enemy will ever out-crazy us into leaving this region.**
> **Israel plays ... by what I've called "Hama rules" – war without mercy.**
> **… It is not pretty, but this is not Scandinavia. The Jewish state has survived in an Arab-Muslim sea because its neighbors know that for all its Western mores it will not be out-crazied. It will play by local rules …which is why Israel's generals know they possess significant deterrence against an Iranian bomb.**
>
> **Thomas L. Friedman**
> **NY Times Op-Ed Columnist**
> **August 12, 2015**

> **If I were Israel's prime minister, I'd start by admitting that my country faces two existential threats: One, external, is an Iranian bomb and the other, internal, is the failure to separate from the West Bank Palestinians into two states, leaving only a one-state solution where Israel would end up governing so many Palestinians it could no longer be a Jewish democracy.**
>
> **Thomas L. Friedman**
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Unless Congress surprises us in September, it appears that a nuclear deal with Iran will be a "fait accompli". Indirectly, the West benefits from the deal through added Iranian energy supplies and new business contracts from a former pariah state. All good for the global consumer markets.

Thomas Friedman (NY Times Op-Ed Columnist) provides a level-headed assessment regarding the recent Iranian nuclear deal. He advises, "… rather than fighting with President Obama, [Netanyahu] as Prime Minister should be telling Obama [that] Israel will support this deal but it wants the U.S. to increase what really matters – its deterrence capability – by having Congress authorize this and any future president to use any means necessary to destroy any Iranian attempt to build a bomb. I don't trust U.N. inspections; I trust deterrence."

Finally, Friedman counsels, "…I'd put all my energies as Israel's leader into trying to securely disengage from the West Bank Palestinians to preserve Israel as a Jewish democracy. That – plus the Iran deal plus enhanced U.S. deterrence – would make Israel more secure against both its existential threats."

It is our belief that the long-term decline in interest rates (1981-2015) will only be conclusively reversed with the outbreak of a major military conflagration involving the USA. A war inevitably entails borrowing (printing) copious quantities of a currency, which inescapably leads to higher interest rates and higher commodity prices. Not so bad for Canada.

The onset of gradually rising U.S. interest rates in the second half of 2015 will not, in our opinion, be enough by itself to precipitate a bear market decline this year.

Respectfully yours,**

Benjamin D. Horwood
Portfolio Manager
August 17, 2015

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 news for your Fund.