VALUE CONTRARIAN ASSET MANAGEMENT

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2005 Year End
Value Contrarian Canadian Equity

Dear Investors,

> ***You, who are leading your country (Iran) in an ideology of hatred, terror and anti-Semitism, had better take a glance at history and see what became of tyrants who tried to annihilate the Jewish people… They brought only destruction upon their own people… Israel's policy is to bring this hot potato (nuclear program) to the Security Council to impose sanctions and invasive inspection.***
>
> ***Shaul Mofaz***
> ***Israeli Defense Minister***

> ***Hurricanes Katrina, Rita and Wilma brought us a brief taste of $70 oil, but not peak oil prices. The next major Middle East oil supply disruption/shock will, in our opinion, likely mark the peak in world oil prices. It will also hit the global economy with a major business recession – and eventually stock market bargains. The only question remains when?***
>
> ***Benjamin Horwood***
> ***January 5, 2006***

Iran, Iran, Iran… All the pieces of the puzzle are slowly falling into place for another 1970's-style oil shock based on Persian Gulf geo-political events. We have been talking about the possibility of an oil crisis for over a year and in 2006 it now appears to be coming closer to reality.

Over the past few years Iran has been playing a shrewd nuclear game of "cat and mouse" with Europe, America, and the International Atomic Energy Agency. Iran's undeclared goal is

obviously, as one newspaper colourfully depicted: "…to put itself within a screwdriver's turn of building an atomic bomb".

Iran's move the other week to restart its uranium enrichment program has precipitated an international crisis. In the eyes of the West, they have crossed the "red line". Tehran appears to be girding for a protracted conflict. This week it announced that it was pulling its foreign currency deposits from European banks.

On the diplomatic front, any UN sanctions will need the approval of both Russia and China, who often have interests not aligned with those of the West. These two powers also have deep economic links to Iran. The question remains whether the prospect of an Iranian bomb is unsettling enough for Russia and China to act in concert with the West.

Iran's economic minister has already warned that they would retaliate against western economic sanctions by cutting oil exports. Under this scenario $90 oil is not a fantasy. Nonetheless, U.S. pressure on Iran will be applied "gradually" and "incrementally". Any UN sanctions are still months down the road. Iran is betting the Security Council will stay clear of the toughest economic sanctions at a time of rising energy prices, since the country is the world's fourth-largest oil and second-largest natural gas producer.

In light of the above situation, it's still too early to sell one's energy stocks. If the conflict escalates into a full blown showdown (political or military) we would view any stiff stock market (bear) sell-off as a golden buying opportunity. Bottom line – Iran must sell oil to survive.

Central and South America in recent years have not been an overly positive experience for Canadian Corporations bent on international growth strategies. Think Labatts (Mexico), Molsons (Brazil), and Scotia Bank (Argentina). Plain and simple, their timing often stinks!

Thus we cringed upon hearing in December that Scotia Bank made a major investment in Peru to gain majority control of a local bank. If Canadian business history in Latin America is any guide, the region will suffer a major economic blow-up within the next 12-24 months, and asset prices will become a lot cheaper. Recent polls in Peru show that in the upcoming April presidential election, the left-wing opponent of free trade and free market policies had surged to the lead.

As we've often stated, the time to make successful investments in emerging markets (ie., China, Russia, Latin America, etc.) is 6-18 months after a major economic crisis/ meltdown has occurred. In that regard, Saputo Cheese got in right when making its dairy investment in Argentina.

Third World blow-ups are inevitable. It just takes patience, savvy, and great timing to make prudent and profitable investments in volatile emerging markets.

Final banking note. Watch for the Royal Bank to make a bold strategic move in the U.S. As we've stated in the past, Royal will turn its U.S. Centura Bank from an insignificant ugly duckling into a white swan. How, you ask? By swapping Centura for shares in Sun Trust! Sun is a dominant, well-run bank in the fast growing southeastern U.S. market.

2005 Performance: +14.4%

January 1, 1997	—	$1,000.00 (inception NAVPS*)
December 31, 2005	—	$2,364.43 (NAVPS)
December 31, 2005	—	$0 distribution per unit
December 31, 2005	—	$2,364.43 (NAVPS after distributions)

Your fund ended the year with a net asset value of $2,364.43 per unit. There were no distributions declared for 2005.

A benign interest rate environment and rising commodity prices powered the TSX to its third year of double-digit gains. The sectors contributing to the index's biggest moves were energy, metals and finally banking/financial services. As the business cycle grows older, the stock market gains are coming from a narrower base of the Index, increasingly the cyclical energy sector. When one sector (energy) or individual stock becomes such a large portion of the total Index, the diversification risks are obvious (think Nortel).

As previously mentioned, we feel it is still too early to sell our energy stocks. Nonetheless, most investors don't realize if bought today (with oil at $68), energy stocks have become speculative investments. Investors seem to have forgotten that energy company profits are, to a large degree, based on a commodity price which has little degree of predictability and is prone to wild swings.

In its latest quarter, Exxon profits surpassed $10 billion dollars and were 44% ahead of last year's profits. Yet the company produced 1% less fuel than a year earlier. How many companies do you know that produce 1% less "widgets", yet increase profitability by 44%??

Energy stocks are not "conservative" investments at today's prices. Rather, they are a speculative bet on the direction of oil prices. Investor brilliance can also be called "rising oil prices".

Iran and Nigeria may be our "energy" salvation for the coming year. Hopefully we will pare our energy holdings at an opportune moment. (Kindly note that your fund manager is not an oil expert, but rather a purveyor of common sense and prudence.)

During the fourth quarter we took advantage of weakness in the share prices of property and catastrophe insurance companies, caused by the back-to-back hurricanes in the U.S. Gulf Coast region. We added to our positions in Renaissance Reinsurance, Montpelier Reinsurance, and White Mountain Insurance. Obviously we expect cat (catastrophe) insurance rates to firm up in 2006, which bodes well for these companies.

Year-end tax loss selling in Eli Lilly shares sent the stock to fifty-two week lows. This gave us the opportunity to significantly increase our position at a very reasonable valuation. Lilly has no patent expiration issues in coming years and a good pipeline of potential new drugs.

* Net Asset Value Per Share

In the Canadian markets, we did very well in 2005 with two Quebec small cap stock additions – Lassonde Industries (fruit juices) and Logistec (port shipping handlers). During the fourth quarter, we hopefully added another Quebec small-cap value "bijoux" to your fund – Cogeco Cable, Canada's fourth-largest cable company.

Unfortunately, just as the company was starting to grow again, (having withstood the competitive effects of the introduction of satellite T.V.) Cogeco's President announced his intention to seek new cable acquisitions (likely in Europe).

The press had a field day, calling it derisively Louis Audet's "European vacation". As president and controlling shareholder of Cogeco, the logic of far-off acquisitions and empire-building overtones sounded a bit like another familiar Canadian business story – Seagram's and Edgar Bronfman Jr.

The investment community choked on the acquisition strategy and the stock was hammered from the low $30's to $23. That's when your fund stepped in and bought shares in the $23.50-$25.50 range. We place a private market value on the stock of $40 based on previous cable sale transactions.

Obviously we (and the markets) feel that Mr. Audet should instead be preparing for the second tsunami rolling into Cogeco's cable territory over the next 24 months. It's called IPTV – cable T.V. provided over the telephone lines by Bell Canada.

Despite the looming competition from Bell, Cogeco is growing again as a result of new internet telephony services (VOIP), upgrades to digital cable service, and high speed internet usage.

Unless Mr. Audet is able to "steal" a European cable company, we don't think he will embark on a foolish growth strategy. In the meantime, the company has two years of solid growth ahead of it. A takeover would be icing on the cake. Roger's Communications already controls 15% of Cogeco Cable stock. Videotron would be another interested buyer. Any further consolidation in the cable industry would also have a positive impact on Cogeco's stock price.

While we'd like to report that we only buy stocks that go up in value, unfortunately this is not always the case. Yes we do make mistakes and sometimes end up with a "torpedo" stock. Simply stated, this is an investment euphemism for a stock which blows a hole in a portfolio (drops 50%+). Obviously, proper diversification mitigates such hits.

Our torpedo candidate for 2005 was far and away Advanced Fiber Income Fund, a small global manufacturer of industrial screens for the pulp and paper industry.

We failed to fully grasp the extent of structural and competitive changes occurring in this niche market. High debt levels and an indefinite distribution cut provided the "coup de grace" to any quick recovery for this business trust.

It is our prediction that when the next major recession rolls around, the Business Income Trust Sector will be devastated with numerous distribution cuts/suspensions. Canada's answer to the U.S. high yield bond market will not be a pretty sight. Nonetheless, great buying opportunities will eventually prevail in the business trust sector.

2006 Outlook

> ***The West has lost its leverage (over Iran)… After the U.S. invaded Afghanistan and Iraq, the Iranians knew they needed an insurance policy. So they did two things: They concentrated on developing a nuclear bomb and went out and struck gas deals… with India and China, the world's two fastest growing energy consumers.***
>
> ***Gal Luft***
> ***Institute for the Analysis of***
> ***Global Security, Washington DC***

Experience has taught us that expensive stock markets are not a reason alone for stock prices to fall. One market analyst always asks the following simple question: "Has anything really changed (of significance)". Bear market (20%+) declines are more likely to occur when you can say "YES" to the latter question. A "yes" is usually the result of an unexpected extraordinary financial or geo-political shock. Example: an attack/blockade against Tehran's nuclear facilities.

Unlike last year at this time, almost no commentators on Bay or Wall Street are talking about the possibility of rising long-term interest rates. Thus rising interest rates could be a surprise wild card factor in 2006. Yet on a positive note, inflation remains in check and long-term (30 year) Canadian bond yields are at 4.1% today, compared with 4.89% last year.

What has changed today is that stock prices are not as cheap as they were at the market bottom in October 2002. When there is less of a "margin of safety", that simply means there are more risks, and obviously more caution is warranted. Preservation of your capital is always uppermost in our mind.

Nonetheless, we think that our recent purchases of Cogeco Cable, Tyco, and Walmart demonstrate that "value" opportunities surface at all stages of the stock market cycle. Patience is the key.

Iran and Middle Eastern political instability will be another wild card factor during 2006 and in years to come. A loss of Iranian or Middle Eastern oil supplies would send prices through the roof. Any ensuing oil shock would certainly squeeze corporate profits and stock prices.

After three years of double-digit gains, TSX returns in 2006 will likely be more muted and volatile, unless oil prices spike to record new highs. Simply stated, if energy stocks are up for the year, the TSX will be up, and vice versa. Feels like it could be a "Nortel" kind of year with the energy sector now accounting for 29% of the TSX Index (in 1998 energy was only 8.5%).

Year-End Management Note

> ***Probably 99.9% of investment management firms that sponsor mutual funds are there to take your money for management fees… We've taken the approach that if we do a good job of managing these portfolios and we're the largest shareholder in the funds, the performance will take care of South eastern's revenue growth – i.e., the funds will grow and happy shareholders will add more capital and eventually the word will get out and others will partner with us.***
>
> ***Mason Hawkins***
> ***Longleaf Partners***

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. 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 one of the better performing funds, even if that means limiting the Fund's size or closing it in the future. We want to enjoy coming to work everyday. We view the Value Contrarian Fund more as a private partnership, where "membership has its privileges". Our size is our great advantage.

Being the second 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 the trust you have placed in us during the past year.

Special thanks to my Editor, Karen Molgaard, who actually makes all of our investment letters readable. Also, special congratulations to my assistant Kathleen Way on the recent birth of a beautiful son – Austin Louis. Replacing Kathleen for the year will be Angela Schade, formerly of Nelson, B.C. (practice your French with her!). Angela also has that warm, helpful personality we admire. So don't be afraid to call Angela for any questions you may have concerning your account.

We do appreciate your **referrals** of qualified new fund investors. Next entry-date into the Value Contrarian Fund: February 27, 2006. Call today (514) 398-0808.

Respectfully Yours,**

Benjamin D. Horwood
Portfolio Manager
February 1, 2006

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 period of negative returns or a year of underperformance. Unfortunately, human nature prefers the exact opposite.