

2003 Second Quarter Value Contrarian Canadian Equity

Dear Investors,

[According to behavioural finance] investors are over-confident ... They believe in winning streaks and are impressed by short-term success. They over-react to both good and bad news. Worse, most of them are trapped in a cycle of fear and greed. When the market goes up, they are desperate to rake in more than their neighbours. When it falls, they become convinced that it will never recover. These traits were much in evidence during the 1990's.

***The Economist
July 5, 2003***

It never made sense to me why, if a bank underwrote an initial public offering*, they published a research report on the company. Whoever had the slightest amount of (common) sense would know that this research report was biased.

***Jack Dzierwa
Former analyst
Salomon Smith Barney***

The North American stock markets appear to have bottomed in March of this year. However, it will be the next consumer lead recession which will tell us if 2003 was really the bear market bottom. Please don't ask us to forecast when the next consumer recession will occur. Economic forecasting is certainly not a science, nor our area of expertise. Likewise for currency forecasting.

The American economy is firmly in the grip of a unique post-bubble business cycle. Standard policies such as interest rate and tax cuts have been largely neutralized by the excesses of the

* The procedure of taking a private company public.

1990's. And while the recession was short and mild, its effect on corporate profitability was devastating over the past three years.

A common complaint we hear today is that the major stock indexes are not "cheap" on a historical basis. But, neither were they inexpensive at the peak of the bubble in early 2000. Yet for example, in late 1999 and early 2000 (bubble years) we were still able to pick up cheap Canadian bank stocks and the Sun Life IPO at book value.

The moral of the story is that attractive (undervalued) investment opportunities are always surfacing, whatever the P/E multiple on the major indexes and at all stages of the business cycle. One has to look no further than Warren Buffett, who recently made a takeover offer for the shares of publicly traded Clayton Homes. The key words are patience, selectivity and the fact that investors shouldn't try to time the market.

We continue to search for undervalued companies which have demonstrated the ability to produce profitable growth. We believe that profitable growth over the next ten year period will likely be found in Healthcare, Financial Services, Hotels and the Oil sector. These industries are well represented in the fund's portfolio. They also have "demographics" working in their favour.

Mr. Greenspan's policies have never been more stimulative. However, the Fed's aggressive efforts to steer the economy away from deflation may lead to "mini-bubbles" in a range of assets (i.e.: Income trusts, long bonds, certain real-estate) over the next few years.

We remain optimistic for the remainder of the year based on the prospects of better growth in the U.S. economy and the likelihood of lower interest rates in Canada. But many factors conspire against the reappearance of boom conditions (i.e.: no pent-up demand for autos, housing or computers). It remains a stock pickers market, an environment which your portfolio manager finds most advantageous.

Second Quarter Performance

Your fund ended the second quarter with a net asset value of \$1,709.33 per unit, an increase of \$68.09 from the December 31, 2002 asset value of \$1,641.24 per unit.

After bottoming during the month of March, the stock markets roared back during the second quarter. The month of April alone reversed the negative returns the fund experienced in January, February and March. Unfortunately, the 17% decline in the U.S. dollar during the first half of 2003 dampened the otherwise excellent performance of our U.S. holdings. Subsequent to the second quarter, the Canadian dollar weakened as the Bank of Canada lowered interest rates. Should this trend continue, we could see further declines in the Canadian dollar, a situation which would enhance our performance.

During the quarter there were no significant additions or sales to the portfolio. However, we did purchase a few “look-see” positions. These are situations where we buy a small opening position in order to watch and familiarize ourselves with a company. Later, should the price be right, we will add to the position as our comfort level rises.

“Look-see” purchases included SNC Lavalin, Cossette Communications, the largest Canadian owned advertising company and Montpelier Re, the Bermuda based property & catastrophe reinsurance company.

Montpelier Re was started in the aftermath of 9/11 by a company already in our holdings, White Mountain Insurance Group. The company went public in October of 2002 in order to take advantage of the substantial increase in demand for catastrophe reinsurance products.

Reinsurance companies provide insurance to existing insurance companies. Example, when your home insurer wants to transfer some of the risks of having too much exposure to homes in hurricane prone Florida, it buys reinsurance.

What we like about Montpelier Re is that it has all the characteristics of a great business. These include high returns on equity, low levels of debt, lots of free cash flow and minimal capital expenditures. Most importantly, the company has very smart backers and management who think and act like owners. Based on 2003 earnings, the stock was trading at a P/E ratio of 7.5x and 1.25x book value.

In light of market conditions and our being fully invested, we will be much more opportunistic going forward. Thus, in certain of our holdings, we may be much quicker to take profits than in the past. The brokerage community is already licking its lips! We continue to find attractive investment opportunities for your fund and expect further positive results during the second half of 2003.

Outlook

If the (Fed) heats things up, it is bad (inflation + rising interest rates) and if they don't heat things up, it is worse (deflation). They have clearly chosen to try to heat things up. You've got an election next year ... My guess is we'll have a great quarter, maybe a little longer than a quarter, then rates go up and it will end almost immediately. There is not a lot of pent-up demand (i.e.: housing or autos). All the pent-up demand is coming from driving rates lower and lower and lower.

**Ned Davis
Ned Davis Research**

Despite the fact that the general stock indexes are not cheap, the major elements are in place for positive market gains over the next twelve month period. In the middle of June, thirty year Government of Canada bonds yielded 4.75%. These record low yields were not sustainable unless one expected the North American economies to drop into a Japan style deflation. Negatives also hitting bond prices have been the renewed interest in equities and hopes of economic recovery.

By the end of July, long bond prices had plummeted, with yields rising to over 5.40%. Those who over the past six months bought 10-30 year bonds for "safety" reasons are now licking their wounds with large capital losses.

In the medium term, as the economy strengthens and the potential for some inflation appears, interest rates should eventually rise. An interest-rate increase would hack away at the value of bond funds as well as bond equivalent investments (i.e.: income funds/REITs).

Greenspan has not given specifics as to how long he would be prepared to keep short-term interest rates at their current levels. It could be well into 2005. When the time does come to raise rates, there will likely be juicy opportunities in the income fund sector. Until then it will be a game of musical chairs. The music stops when Greenspan signals rates are going up.

For the time being, the coast is clear and we remain fully invested.

Respectfully Yours,**

Benjamin D. Horwood
Portfolio Manager
July 31, 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.