VALUE CONTRARIAN
ASSET MANAGEMENT

2017 Third Quarter
Value Contrarian Equity Fund

Dear Partners,

> **As I said, expansions [bull markets] don't die of old age – they go on until something kills them. …The most common cause of U.S. recessions in the postwar era has been monetary tightening by the Federal Reserve as a means to fight inflation.**
>
> **Alan S. Blinder**
> **Professor of Economics**
> **Princeton University**

The granddaddy of economic expansions was the remarkable 120-month expansion from 1991 to 2001. To top that, the present economy would have to continue growing past 2019, according to professor Blinder. Simply stated, the U.S. markets have been on a roll since 2009. However, Toronto did suffer a bear market pause in 2015-2016.

Just as economic expansions don't die of old age, history has also demonstrated, that stocks can stay cheap or expensive for extended periods. Stocks don't fall just because they are fully valued, there needs to be some sort of catalyst.

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"Valuation" alone is useless in predicting the markets direction in the next quarter, year, or even few years. But, over longer periods, "valuation" is the closest metric to "gravity" that stocks have. Stock prices will eventually reflect the value of the underlying businesses they represent. In other words, high stock valuations are eventually subject to the laws of bear-market gravity.

It is interesting to note, that investors have not fully embraced equities again since the 2007 - 2009 financial crisis. This, despite the more than 200 per cent total return for the S&P 500 from its post-crisis low in March 2009.

It was shaping up to be a lost year for Canadian equities until the recent September/October rebound. The September rally has finally put Toronto in the black for 2017. Nonetheless, the TSX Index has lagged all the major U.S. stocks indexes due to its high commodity component (trees, rocks & water).

We expect the TSX to outperform in 2018 as a result of this significant underperformance over the past year.

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Third Quarter Performance

How does one make money? Determine what's the consensus opinion, then figure out where it's wrong (i.e. Hillary – Brexit)

Ben Horwood
November 1, 2017

Your Fund ended the September third quarter with a net asset value of $3,672.64 per unit, an increase of $79.20 from the December 31, 2016 net asset value of $3,593.44 (after distributions). This represents a year to date return: +2.30%.

The rising Canadian dollar has continued to negatively affect the approximately fifty percent of our portfolio held in U.S. dollars. The Canadian dollar started the year at 0.74 cents and finished the third quarter at 0.80 cents. On a positive note, the rising Canadian dollar has partial reversed course in October. Until September 20, the blue chip TSX 60 Index was in negative territory for 2017. What a difference the last six weeks has made!

The markets never fail to make us look dumb! Wise investors learn early on to always expect the unexpected. The only thing "certain" is that there will always be "uncertainty". Last year I predicted, should there be a Trump win, the markets would fall 10% - 15%. Instead, Trump won the presidency and the U.S. markets rose dramatically. Your manager failed to determine what the consensus opinion was, and where it was wrong.

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Finally, on October 27, the TSX made new all time highs. Canadian investor frustration has been palatable, as U.S. stocks Index's soared in 2017, producing double digit returns. Poor Canada, up until September, the TSX had been dead in the water, and one of the worst performing stock markets in the industrialized world.

As we've stated earlier, history has shown that bull markets don't die because stocks are expensive or fully valued. Rather, it usually takes either a sustained amount of rising interest rates, an inverted yield curve, or an earnings recession.

In addition, geopolitical events could easily lead to a 5% - 10% correction. Watch for Trump to issue the six-month notification to leave NAFTA. Starting the clock on America's intent to withdraw from NAFTA could easily spook the equity markets. Enjoy the ride – as market swings will become much more accentuated over the next six to twelve months.

Now for the good news. Historically, the commodity laden TSX outperforms late in the economic cycle. With large underperformance in 2017, 2018 could easily see the TSX play catch up. We would not be surprised to see the TSX produce double digit returns in 2018 on the back of "trees, rocks & water".

Respectfully yours,

Benjamin D. Horwood
Portfolio Manager
November 6, 2017

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P.S. Do visit us at our **NEW** 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.

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